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November 17, 2010

Mr. David Stawick
Secretary
Commodity Futures Trading Commission
1155 21st Street, NW
Washington, DC 20581

RE: *Proposed Rules on Conflicts of Interest*

Dear Mr. Stawick:

The IntercontinentalExchange, Inc. ("ICE") appreciates the opportunity to comment on the Commodity Futures Trading Commission ("CFTC" or "Commission") proposed rulemaking addressing conflicts of interest in the derivatives industry. As background, ICE operates four regulated futures exchanges: ICE Futures US, ICE Futures Europe, ICE Futures Canada and the Chicago Climate Futures Exchange. ICE also owns and operates five derivatives clearinghouses: ICE Clear US, a Derivatives Clearing Organization ("DCO") under the Commodity Exchange Act ("Act"), located in New York and serving the markets of ICE Futures US; ICE Clear Europe, a Recognized Clearing House located in London that serves ICE Futures Europe, ICE's OTC energy markets and also operates as ICE's European CDS clearinghouse; ICE Clear Canada, a recognized clearing house located in Winnipeg, Manitoba that serves the markets of ICE Futures Canada; The Clearing Corporation, a U.S. DCO and ICE Trust, a U.S.-based CDS clearing house. As the operator of a diverse set of exchanges and clearinghouses based in three countries, ICE has a unique perspective on the ownership requirements and conflicts of interest rulemakings proposed by the Commission (the "Proposal").

General Comments on the Proposed Rulemaking

ICE has always supported independent corporate governance. However, ICE believes the Commission's proposed rulemaking on conflicts of interest is attempting to address an ill-defined issue using too many prescriptive rules. For example, the Proposal points to possible conflicts, such as the members of a DCO risk committee preventing certain swaps from clearing in order to benefit their businesses. This appears to be a problem in theory only, and ignores commercial realities as well as provisions of Dodd-Frank. A DCO has a strong profit motive to clear as many swaps as it can so long as they do not pose undue risk. The CFTC and other regulators have an integral role in determining which swaps are clearable. In addition, any theoretical incentive to prevent swaps from being cleared is largely undercut by the prospect of prudential regulators imposing capital charges on non-cleared swaps that make the cost of such instruments expensive. Yet the Commission proposes very prescriptive rules in company ownership,

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corporate governance, and DCO risk management. In essence, the Commission's Proposal is an unnecessary experiment in market design.

Historically, experiments in market design have had unintended consequences. In the context of the proposed rulemaking for DCOs, the Commission is attempting to mandate the composition of boards and risk committees in order to achieve the desired result of clearing more products. However, by introducing more heterogeneity and *less expertise* into these committees, the Commission may not only slow down or complicate approval of new products, but may also induce more risky behavior. As Professor Craig Pirrong, a participant at the Commission's hearing on the proposed rules states: "heterogeneity imposed by regulatory fiat–engineering of the organization and governance of CCPs–is rife with potential for disaster. There is a serious potential for misalignment of incentives and distortions in risk taking. Which....defeats the entire purpose of a clearing mandate."[1]

DCOs fulfilled their intended functions and were one of the few parts of our market structure that worked properly during the financial crisis—and they have been steadfastly doing so for decades. ICE submits that experimenting with a model that is working as it is supposed to work is both risky and entirely premature. Dodd-Frank does not require the Commission to adopt the rules in the Proposal, and the Commission should refrain from implementing them unless and until there are clear signals that a problem actually exists.[2] Again, ICE supports strong, independent corporate governance of exchanges, swaps execution facilities and clearinghouses. However, we believe the Commission should re-consider whether to address the concerns outlined in the proposed rulemaking at this time, and should generally take a more flexible approach regarding the proposed amendments to existing standards, as described below.

Specific Issues in the Rulemaking

I. Definition of "Public Director"

The definition of the term 'public director' specified in proposed rule 1.3(ccc) reflects changes from the definition contained in the Commission's guidance on compliance with Designated Contract Market ("DCM") Core Principle 15 that took effect earlier this year (the "Safe Harbor"). The Safe Harbor reflected the result of a two-year study of exchange governance and conflicts of interest, which culminated in the implementation of the public director definition of the Safe Harbor. Without any anecdotal evidence suggesting that the Commission had erred in adopting that definition,

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[1] The entire article on mandating participants on DCO committees can be found on Professor Pirrong's website: http://streetwiseprofessor.com/?p=4448

[2] In contrast, the Commission's first rulemaking on conflicts of interest for DCMs followed a lengthy survey of market participants to indentify actual conflicts of interest.

the proposed rule radically alters it in several respects. One of the key changes is the addition of all employment relationships to the bright-line test of materiality, which will have the effect of further restricting the pool of candidates who may serve as public directors of a governing board and public members of certain committees. In addition, the proposed amendments will disqualify potential public directors if a family member is employed in any capacity by a firm that provides business services to a member of a DCM or other registered entity or an affiliate of such a member. Although the Commission states that the changes underlying its Proposal are intended to conform the rules with applicable SEC standards, they appear to be derived —but dramatically altered—from NYSE standards for determining the independence of directors of listed companies. The breadth of the alterations suggests that the Commission has not carefully considered the impact they will have.We therefore urge the Commission not to make these changes, for the reasons described below.

A. Employment Relationships

Under the Proposal, a director could no longer be deemed public if the director (or an immediate family member) is an employee of (i) a member of the registered entity or (ii) an entity that receives more than $100,000 in combined annual payments from any member of the registered entity or affiliate of such member, for legal, accounting or consulting services.[3] In proposing these changes, the Commission ignores the many comments it received during the preceding rulemakings that pointed out the inherent flaws in using employment as a disqualifying event, and which led the Commission to remove employment relationships from the bright-line test of the definition before it became effective. In support of this sweeping about-face, the Commission alludes to a comment letter observing that it was possible to comply with the Safe Harbor even if all public directors are employees of members of the DCM. We do not believe that any exchange has or would constitute its governing board in this way, and the Commission noted, when rejecting the comment, that such a situation would run afoul of the over-arching materiality test. The Commission's reasoning at that time is no less valid today.

The determination of whether an employment relationship gives rise to a conflict of interest should be left to the sound discretion of the governing board because it is a fact-specific matter. This will allow relevance and materiality determinations to be based on the nature of the employment, rather than automatically disqualifying a director from public status. A governing board would then be able to distinguish between a family

[3] Neither the current definition of public director nor the Proposal sheds light on what is intended to be covered by the term "consulting" services. The Commission should clarify that the services must relate to the conduct of the recipient's business on the exchange, and not the conduct of its business in general. Otherwise, any provider of goods and services could be said to have been consulted by an exchange member. In addition, the term should apply only to firms engaged in the consulting business, and not to firms that may provide such services incidental to their line of business.

member who is employed in a clerical capacity by a foreign affiliate of an exchange member and one who is the senior vice president of the foreign affiliate. In this manner, true conflicts of interest can be ferreted out from those that may not even rise to the level of creating the appearance of a conflict of interest. The rule should allow for these kinds of distinctions to be made, rather than impose a blanket prohibition.

By adding members and member affiliates to the analysis required under the bright-line test regarding indirect compensation, the Proposal creates special, new problems. Specifically, in order for a director to be deemed public, the governing board would have to determine whether aggregate fees paid by members and member affiliates for legal, consulting or accounting services to a firm at which a family relation of the director was employed, exceeded $100,000. Here again, the Commission takes two different NYSE tests and combines them to create a new test that is over-broad, will be difficult to verify and could exclude from public status many otherwise qualified individuals. NYSE standards preclude a director from being deemed independent if the director is a current partner or employee of the listed company's internal or external auditors, or if an immediate family member is so employed and works on the audit of the listed company. The NYSE standards also preclude a director from being deemed independent if the director is an employee, or a family member is an executive officer, of a company that has made payments to, or received payments from, the listed company for property or services exceeding the greater of $1 million or 2% of such other company's consolidated gross revenues. In contrast to these standards, the Commission adopted a $100,000 test, made it applicable to a firm that employs the director or a family member in any capacity, and then limits eligibility not on the basis of a relationship between the employing firm and the registered entity, but rather, on the basis of a putative relationship between the employing firm and a member of the registered entity. Moreover, the indirect compensation is measured by the existence of minimal payments for professional services that may have nothing to do with the business of the registered entity. It is difficult to imagine a more exclusionary rule.

The scope of the inquiry that would be required under this indirect compensation rule would be enormous and the results of dubious value in many cases, for example, where the family member is an employee who is not a partner or other principal of the firm providing the service. Such employees would not have access to (or be at liberty to disclose if they had such access) a roster of the firm's clients. The firm, in turn, would have no incentive to make its roster available to the registered entity to cross-reference against its members and their affiliates because the firm has no relationship with the registered entity. Both the list of members (and affiliates) as well as the firm's clients will change regularly and even one such change could affect the outcome of the analysis given the low dollar threshold of the proposed rule. Thus, in order to ensure that decisions were based on an accurate record, the firm would need to be in constant contact with the registered entity. Moreover, because the definition of "member" to be applied

for this purpose is so broad, it would require (in the case of ICE Futures US alone), more than a thousand members, permit holders, member firms and market participants with direct access to the trading platform of the exchange—and all of their respective affiliated firms –to be cross-checked against the client roster of the service provider. Given the impracticalities posed by this situation, more likely than not, the registered entity would be forced to drop the director from consideration.

The inclusion of employment relationships and the addition of members and their affiliates to the indirect compensation test is ill conceived and will do more harm than good by needlessly shrinking the talent pool from which public directors are drawn at a time when there will be more registered entities than ever before seeking to recruit such individuals. We urge the Commission to reconsider the consequences of the Proposal and not amend the definition of public director in these respects.

B. The Compensation Test

The current definition in the Safe Harbor sets the level of indirect compensation at only $100,000. We continue to believe that this threshold is much too low and needlessly disqualifies individuals who should not be deemed to have a material relationship with the registered entity. Payment of a $100,000 legal or consulting fee to a firm with $250 million in annual revenues would not give rise to the same considerations as payment of that amount to a firm with annual revenues of only $2.5 million. The board of the registered entity should be entrusted to evaluate all the relevant facts and circumstances associated with a particular director, just as it must do for any other situation that is not specifically covered by the bright-line test, and determine whether the independent judgment of the director would be compromised by the indirect compensation arrangements. In the event that the Commission wants to question the decision-making of a registered entity in a particular case, it can always review the records relied upon by its governing board in making the required public director findings. To the extent that the Commission nonetheless concludes that specification of a dollar threshold as an exclusionary level is necessary for purposes of indirect compensation, we encourage it to adopt a more meaningful level by significantly increasing the amount along the lines of the NYSE level referenced above.

The Proposal also seeks to amend the definition of public director for purposes of service on the Regulatory Oversight Committee ("ROC"), or the newly proposed Nominating Committee, Membership Committee and clearinghouse Risk Management Committee. In these cases, the public director (and any family member) may not be an officer, director, partner or employee of a firm that has received *any* compensation for providing the specified services to the registered entity (or its affiliates) or to a member of the registered entity (or a firm affiliated with such member). In this fashion the Commission seeks to eliminate broad categories of professional service providers and

consultants[4] as a potential source of public committee members if the service provider has received even *de minimis*. Because a ROC must be constituted entirely with public members, such a rule risks posing a hardship on the DCMs that already have constituted their ROCs in compliance with the standards of the Safe Harbor. This broad new prohibition might preclude incumbent ROC members from service and will make it increasingly difficult to find qualified individuals with the necessary industry expertise to replace them. As with the other changes to the definition of public director, there is nothing that indicates the payment of indirect compensation of an immaterial amount would sway public committee members and cause them not to exercise independent judgment. We disagree with this extreme restriction and suggest that the same standard used for determining governing board member eligibility be applied to determine ROC eligibility.

II. Committees

A. Risk Committee

Proposed Rule 39.13 is too prescriptive and overreaching with respect to the nature and extent of the responsibilities and authority conferred upon a risk management committee. Specifically, as proposed, the rule provides that a risk management committee shall among other things: *determine* the standards and requirements for initial and continuing clearing membership eligibility; *approve or deny* (or review approvals or denials of) clearing membership applications; *determine* products eligible for clearing; and review the performance of the Chief Compliance Officer and make recommendations with respect to such performance to the Board of Directors. ICE recognizes that a risk management committee serves an extremely important role with respect to the operation of a DCO. However, the corporate documents of a clearing house do not typically vest such a committee with authority for the management of the clearinghouse. More typically and appropriately, the responsibility for management of a clearinghouse vests with its board of directors and a risk management committee merely, but importantly, advises the board of directors. Accordingly, ICE submits that it would be more appropriate for Rule 39.13 to provide that a risk management committee shall *advise* the governing board with respect to the standards and requirements for initial and continuing clearing membership eligibility; *advise* the board (or review approvals or denials) with respect to clearing membership applications; and, *advise* the board with respect to products eligible for clearing. Furthermore, ICE questions whether a risk management committee is in the best position to review the performance of the Chief Compliance Officer. Pursuant to Section 5b(i) of the Act, the Chief Compliance Officer is responsible for, among other things, reviewing compliance of the derivatives clearing organization with respect to the

[4] How the Commission views the scope of activities that are encompassed by the phrase "consulting services", as discussed in footnote 1, could have a profound impact in the context of populating committees.

core principles. The core principles cover every important aspect of a clearinghouses operation. While a number of the core principles fall under the purview of a risk committee (e.g., clearing participant eligibility, product eligibility, risk management, and default rules and procedures), there are a number of core principles that do not fall under the purview of a risk committee (e.g., financial and operational resources, rule enforcement, system safeguards, governance fitness standards, conflict of interest, board composition, and establishing a well-founded legal framework). In addition, the Chief Compliance Officer is responsible for: administering each policy and procedure that is required to be established pursuant to Section 5b(i) and ensuring compliance with the Act and regulations relating to agreements, contracts, or transactions, including each rule prescribed by the Commission; establishing procedures for the remediation of noncompliance issues identified by the Chief Compliance Officer; and establishing and following appropriate procedures for the handling, management response, remediation, retesting, and closing of noncompliance issues. Given the Chief Compliance Officer's general and far reaching responsibilities, ICE submits that the governing board or a board committee with broader responsibility (such as an audit committee) might be in a better position to review the performance of the Chief Compliance Officer, as opposed to a risk committee that has a much narrower focus and expertise related to risk management.

In addition, Proposed Rule 39.13(g)(3)(ii) prohibits an employee of a DCO from being a member of a risk management committee. As a result of their detailed knowledge and direct experience related to risk matters, employees such as the Chief Risk Officer and other representatives of senior management are often in the best position to provide risk-related advice. Including such employees as voting members of a risk management committee ensures that the derivatives clearing organization will receive the full benefit of their knowledge and experience. ICE appreciates that the proposed Rule does not prohibit such employees from attending a risk committee meeting but ICE's experience has been that employees are afforded greater respect and attention and more weight is given to their opinions and advice if they are included as participating members of a committee as opposed to when they merely act as staff administrators.

Finally, the Commission should reconsider whether it is practical to require such a high percentage of the risk management committee be composed of public directors given the relatively small pool of available individuals with the requisite clearing expertise. Based upon the proposed requirement that at least thirty-five percent of the risk management committee shall be comprised of Public Directors with clearing expertise and given a risk committee size of ten individuals, a DCO will be required to find four public directors with clearing expertise. Recognizing the unique nature of the clearing function, ICE submits that it will be impractical and problematic to retain four public directors with the requisite clearing expertise, especially when conflicts of interest

are taken into consideration.[5] Furthermore, if the risk management committee functions as an advisory committee to the board of directors, the interest of having appropriate public director input with respect to risk-related matters would be satisfied at the board level given the public director requirements that will apply to the DCO governing board.

B. Nominating Committees

The Proposal requires registered entities to have Nominating Committees that are comprised 51% with members who would qualify as public directors. Utilizing a nominating committee to identify potential directors for the governing board of a registered entity that is a wholly-owned subsidiary serves no purpose, because the directors are not elected by a large group of shareholders, but rather, appointed by its sole shareholder. The public interest is adequately protected by the public director requirements that apply to the governing board. The Commission should eliminate this proposed requirement with respect to wholly-owned subsidiaries that are registered entities. If a public company is a registered entity, existing laws adequately protect the process of nominating and electing directors.

C. Disciplinary Committees

The Proposal precludes the composition of a disciplinary panel in a manner whereby any particular constituency can dominate or exercise disproportionate influence over the panel. Depending on the number of constituent categories established by a registered entity and the size of the particular disciplinary panel, it may be the case that a majority of the members of a particular panel are associated with one category. For example, a five-member panel comprised of three non-members (one of which is a public member) and two exchange members should not be deemed to be dominated by non-members (and vice versa), even though they constitute a majority. The Commission should clarify that a mere majority does not amount to disproportionate influence or dominance.

D. Clearing Organization Disciplinary Program

The Proposal refers to the possibility of delegating to the risk management committee the performance of the functions of the disciplinary panel. The Commission should not limit such delegation only to the risk management committee. ICE Clear US rules, for example, which were approved by the Commission, provide for the referral of potential rule violations (other than those for which summary fines may be issued) to its parent, ICE Futures US, for investigation and disciplinary action, all conducted in

[5] For example, the person who proposed this at the CFTC hearing, Professor Michael Greenberger, given his short tenure at the CFTC, would probably not have the requisite qualifications to serve as a public director on a risk committee.

accordance with the Exchange's enforcement and disciplinary rules and procedures. This has worked effectively by allowing experienced enforcement staff to conduct the investigation and experienced Business Conduct Committee members to judge the resulting cases and mete out appropriate sanctions.

III. Proposed changes to Part 40

The Proposal requires a corporate parent that "operates" a registered entity to comply with all of the provisions that apply to its regulated subsidiary. In that connection the Commission stated that an entity would be deemed to operate a DCO, DCM or SEF only if it engages in the direct exercise of control (including through the exercise of veto power) over the day-to-day business operations of the registered entity. The Commission should confirm that exercising the power to appoint all of the directors of a registered entity would not cause the parent to be deemed to "operate" the registered entity for purposes of the proposed regulations.

Conclusion

Again, ICE believes in strong, independent corporate governance. However, we are concerned that the Commission is embarking on a risky and unnecessary experiment in market design to redress theoretical conflicts of interest in corporate governance and risk management.We ask the Commission therefore to consider whether the conflicts of interest identified in the Proposal are actual conflicts and whether the Commission's prescriptive approach is the right answer at this time. We appreciate the opportunity to comment on this rulemaking.

Sincerely,

Audrey R. Hirschfeld
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ICE Futures US