Atlanta Calgary Chicago Houston London New York Singapore

December 17, 2010

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

Re: ***Study on Oversight of Carbon Markets***

Dear Mr. Stawick:

IntercontinentalExchange ("ICE") welcomes the opportunity to comment on the Study on Oversight of Carbon Markets published by the U.S. Commodity Futures Trading Commission ("the Commission") in the Federal Register, Volume 75, No. 227, on Friday, November 26, 2010.

ICE operates a leading global marketplace for trading and clearing futures and OTC derivatives across a variety of product classes, including agricultural and energy commodities, foreign exchange and equity indexes. Commercial market participants rely on our products to hedge and manage risk and investors in these markets provide necessary liquidity.

Under the European Climate Exchange brand, ICE Futures Europe operates the market-leading futures and options contracts for carbon dioxide emission allowances issued by national governments under the EU Emissions Trading Scheme ("EU ETS"), as well as providing the busiest platform for futures and options based on developing country emission reduction credits called "Certified Emission Reductions" ("CERs").

In the U.S., the Chicago Climate Futures Exchange ("CCFE") is the lead exchange market for carbon instruments used in the Regional Greenhouse Gas Initiative, as well as those issued in voluntary programs administered by the Chicago Climate Exchange and the Climate Action Reserve. Chicago Climate Exchange ("CCX"), which was activated in 2003, operates a voluntary greenhouse gas emission reduction and trading program. The program has included over 400 participants, with binding commitments to verifiably reduce emissions taken by industrial, governmental and academic institutions. The combined emissions baseline of over 650 million metric tons CO_2, makes the CCX approximately one-third the footprint of the EU ETS.

ICE also operates an internet-based electronic trade confirmation service, ICE eConfirm® for energy and commodity markets. This service matches counterparty trade data to identify discrepancies and execute legal trade confirmations. Users of ICE eConfirm

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electronically confirm their trades online regardless of execution method - whether completed through voice brokers, online platforms, or directly between counterparties. The service provides an efficient, electronic alternative to the historically manual process for confirming trades, and may offer a valuable tool for advancing the trade and position reporting objectives contained in the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"). These data and reporting systems are discussed further below in relation to regulatory oversight and data reporting by carbon market participants.

The following comments address the Federal Register notice questions for which ICE offers relevant expertise.

1. Section 750 of the Dodd-Frank indicates that the goals of regulatory oversight should be to ensure that carbon markets are efficient, secure and transparent. What other regulatory objectives, if any, should guide the oversight of such markets?

Central goals that regulators can help advance for market-based environmental protection programs are robust price discovery for traded instruments and assurance of efficient capital flows to all recognized environmental solutions. Market oversight mechanisms should be able to enforce rules that provide for fair and competitive trading in all segments of the market, while allowing entities subject to environmental mandates to legally achieve compliance at least cost.

These goals are best advanced by integrating expertise from environmental and market regulatory agencies, as well as a diverse range of market participants, into the design of legislation and associated implementing regulations.

2. What are the basic economic features that might be incorporated in a carbon market that would have an effect on market oversight provisions—e.g., the basic characteristics of allowances, frequency of allocations and compliance obligations, banking of allowances, borrowing of allowances, cost containment mechanisms, etc.?

Rule structures that advance the efficient realization of the environmental goals set for industry are also those that are more likely to make the market amenable to sound regulation. Rules that are clear, stable and predictable would imply relatively few major changes over time, which helps avoid the potential for disruptions that harm market participants. Long-term rule stability is especially important to the regulated industrial entities that operate long-lived capital assets.

Rules and regulations covering environmental monitoring and reporting, allowance allocations and auctions, fungibility of instruments, project-based crediting, and other core parameters, should be set upfront for as long a time period as possible. Changes in

rules should occur through an open process that incorporates input from regulated industries, market participants, market regulators and exchanges. Unless warranted by unique circumstances, rule changes should apply prospectively, not retroactively.

An essential tool used in existing environmental trading programs is an electronic tracking registry that serves as a central database for all allowance holdings and transfers across accounts, as well as tracking of offsets and other relevant credits. This database facilitates regulatory oversight of the spot market as all holdings and transfers are listed by account. In the case of the U.S. Environmental Protection Agency Allowance Tracking system used for SO_2 and NO_X allowances, the entire database is publicly available, as are quarterly emission reports (which include CO_2), by facility, that are reported to EPA. Should the program design not provide for public ability to view individual accounts (e.g. as in the case of the Regional Greenhouse Gas Initiative), market regulators will need to work with program administrators to obtain access to the database.

Banking and borrowing provisions can potentially be effective tools for dampening economic exposure of regulated industries, and banking has been used successfully in several existing air pollution reduction programs. Further, these rules can help prevent emergence of price congestion and the potential for inappropriate trading activity that may be encouraged when prices are congested.

While there is understandable attraction to the prospect of containing costs through price caps and floors, their numerous drawbacks potentially outweigh their benefits. The act of having government set a price floor or cap itself could be interpreted by market participants (rightly or wrongly) to be expert information and price predictive. Further, regulators may face new challenges that result from potential gaming opportunities made possible by imposition of price constraints. Price caps and floors may have magnetic effects, either attracting prices to, or repulsing them from, the price boundary levels, with potentially undesirable incentive effects.

If a price cap means that a price level high enough to attract the risk-taking to innovate specific new environmental solutions can never be realized – even if an opportunity to sell credits at that price is just momentary - then development of that new solution will be discouraged. In addition to presenting administrative challenges, such as price floor selection and enforcement, price floors have economic drawbacks. For example, a binding price floor in the EU ETS would have meant the beneficial counter-cyclical macroeconomic effects of low emission allowance prices during the recent economic contraction would have been foregone.

3. Do the regulatory objectives differ with respect to the oversight of spot market trading of carbon allowances compared to the oversight of derivatives market trading in these instruments? If so, explain further.

While there are multiple facets of the markets, each is, nevertheless, part of a single total market. Accordingly, the primary goals of the regulatory architecture should be the same across market platforms – fair, transparent and efficient markets that are free of manipulation. Naturally, each market segment may merit monitoring and regulations that fit the circumstances, e.g. rules for margin-based trading may appropriately differ from those of spot and OTC markets.

4. Are additional statutory provisions necessary to achieve the desired regulatory objectives for carbon markets beyond those provided in the Commodity Exchange Act, as amended by the Dodd-Frank Act, or other federal acts that may be applicable to the trading of carbon allowances?

The tools now available to regulators, combined with an appropriate reporting mechanism for OTC trades (e.g. forwards, swaps and options) that do not immediately trigger registry-tracked transfers, should provide regulators a sufficient architecture for assuring fair, efficient and competitive markets.

5. What regulatory methods or tools would be appropriate to achieve the desired regulatory objectives?

Addressed in questions 4 and 6.

6. What types of data or information should be required of market participants in order to allow adequate oversight of a carbon market? Should reporting requirements differ for separate types of market participants?

Transaction information should be reported with speed and form sufficient to allow regulators to monitor conditions in the total market. The total market consists of three main segments: spot trading involving deliveries in the program registry (e.g. the U.S. EPA Allowance Tracking System); exchange-traded and/or cleared OTC, futures and option contracts; and OTC derivative contracts that are not cleared through a clearing house. Of these segments, only the uncleared OTC transactions are not currently fully subject to ready monitoring by regulators as a result of electronic recordation of all trades and positions.

The ability to monitor and regulate all market segments is advanced by the guidance on establishment of Swap Data Repositories ("SDR") in the Dodd-Frank Act. In the prescriptive standards that specify the swap data to be collected and maintained by each

registered SDR, the Commission is instructed to include among the duties of an SDR the ability to "confirm with both counterparties to the swap the accuracy of the data that was submitted ... maintain the data.., provide direct electronic access to the Commission... establish automated systems for monitoring, screening, and analyzing swap data."

Via the ICE eConfirm Service, ICE has been successfully offering a trade confirmation system to its energy and commodities customers for over eight years. This service offers a successful model that can be applied to SDRs to meet the data and reporting requirements. Today, more than 200 global trading firms submit their trade data to ICE eConfirm to accomplish legally binding electronic trade confirmation matching. Since the launch of the system on April 29, 2002, some of the milestone achievements include:

- 1,000+ deal types used for confirmation of forwards, swaps, & options
- 25,000+ electronic, brokered, & direct trades confirmed online each week
- 5,100,000+ total trades matched & stored in the data warehouse
- Over 7 trillion USD in notional value of transactions in physical and financial energy contracts, metals, and agriculture.

ICE's commitment to delivering a SDR solution for the energy and commodities asset classes can apply as well to environmental contracts. This solution will be designed to cater to large and small market participants as well as relevant global regulatory bodies. ICE is developing a neutral and unbiased service called Trade Vault as a central database to house the necessary trade records and post trade events in order to accurately generate the reports requested by regulators. The service will allow for accurate calculation of positions and open interest for regulatory reports by tracking all events that occur post trade date (e.g., novations, name changes, close-outs and trades given-up to a clearinghouse). These systems are an example of the technology and reporting systems that could be facilitative in a Commission-regulated carbon market.

7. To what extent is it desirable or not desirable to have a unified regulatory oversight program that would oversee activity in both the secondary carbon market and in the derivatives markets?

The long success of the U.S. SO_2 and NO_X emission reduction and trading programs indicates that existing authority of the EPA to regulate spot market trading, which occurs on the registry operated by the EPA, combined with the Commission's authority over derivatives markets for these instruments, is a successful and appropriate regulatory structure. Please see our response to Question #10 for further input on these issues.

8. To what extent, if any, and how should a U.S. regulatory program interact with the regulatory programs of carbon markets in foreign jurisdictions?

U.S. regulators should actively coordinate with and share lessons learned with relevant international authorities. At a minimum this will include extensive interface with the EU Commission, the U.K. Financial Services Authority, and United Nations officials involved in administration of the Clean Development Mechanism and other UN-sanctioned market mechanisms.

The existing and emerging environmental markets already have multiple years of experience and a very international base of market participants. The experience to date provides a reminder that relevant authorities need to police conventional legal, commercial and operational matters that emerge in all markets. Included among these are tax law violations, registry system security, unauthorized or fraudulent accessing of registry accounts, etc.

9. What has been the experience of state regulators in overseeing trading in the regional carbon markets and how would that instruct the design of a federal oversight program?

[Not applicable]

10. Based on trading experiences in SO_2 and NOX emission allowances what regulatory oversight would market participants and market operators, respectively, recommend?

The Commission has the appropriate experience and authority to regulate the entire derivatives market for environmental commodity instruments. The fact that the environmental authority that operates the registry (e.g., the U.S. EPA) is, in effect, the "host" of the spot market, makes it natural for that agency to regulate spot trading. Indeed, the success and smooth operation of the U.S. EPA SO_2 and NO_X programs indicates that EPA's explicit regulatory authorities[1] to be able to act to assure orderly and competitive functioning of the allowance system have been effective. Should it prove necessary for the conduct of investigations, the Commission can readily access (or arrange to obtain access) the spot market transfer and holdings data in the allowance registry.

To the extent that industries that face compliance obligations include rate-regulated energy firms, early and ongoing efforts to help prepare state and local utility regulators

[1] "The Administrator reserves the right under Title IV of the [Clean Air] Act to take any action necessary to protect the orderly and competitive functioning of the allowance system, including actions to prevent fraud and misrepresentation." *58 FR 3650, Jan. 11, 1993, as amended at 60 FR 17113, Apr. 4, 1995.*

can be advanced through educational programs and model rule provisions that can be developed in cooperation with, for example, the National Association of Regulatory Utility Commissioners (NARUC).

11. Who are the primary participants in the current primary environmental markets? Who are the primary participants in the current secondary allowance and derivatives environmental markets?

The entities identified on these websites, (1) Members of Chicago Climate Exchange, (2) Clearing Members of Chicago Climate Futures Exchange, and (3) Members of ICE Clear Europe, provides an example of the range of firms that participate in current secondary and derivative environmental markets.

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We appreciate the opportunity to provide input for the Commission's study regarding the oversight of carbon markets. Please feel free to contact us should wish to discuss these comments further.

Sincerely,

Michael J. Walsh
Executive Vice President
Chicago Climate Exchange