March 8, 2011

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

RE: Core Principles and Other Requirements for Swap Execution Facilities ("SEFs:), RIN Number 3038–AD1

Dear Mr. Stawick:

IntercontinentalExchange, Inc.("ICE") appreciates the opportunity to comment on the Commodity Futures Trading Commission ("CFTC" or Commission") proposed rulemaking on core principles applicable to swap execution facilities ("Proposal").

As background, ICE operates four regulated futures exchanges: ICE Futures U.S., ICE Futures Europe, ICE Futures Canada and the Chicago Climate Futures Exchange. ICE also owns and operates five derivatives clearinghouses: ICE Clear U.S., a Derivatives Clearing Organization ("DCO") under the Commodity Exchange Act ("Act"), located in New York and serving the markets of ICE Futures U.S.; 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.-based DCO; and ICE Trust**,** a U.S.-based CDS clearing house. In particular, ICE operates Over the Counter ("OTC") energy and credit markets, including the only Exempt Commercial Market ("ECM") with regulated significant price discovery contracts. As a regulated OTC energy market, ICE has a practical perspective on the operation and regulation of SEFs.

Executive Summary

The Commission has put much effort to creating a regulatory structure for swap execution facilities. In the final rulemaking, the Commission should:

- Clarify that all compliance rules apply to SEFs that allow market participants to post indicative prices,

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- Not require the real-time monitoring of intraday position limit rules by SEFs until the technology is readily available,
- Not require SEFs to monitor trading on other SEFs,
- Mandate pre-trade clearing checks for SEFs,
- Clarify that SEFs can use certain non-confidential data for business or marketing purposes; and
- Not prohibit Chief Compliance Officers from serving in the legal department

General Comments on the Proposed Rules

The Dodd Frank Wall Street Financial Reform and Consumer Protection Act (Dodd Frank) creates a sensible regulatory framework for SEFs that implements transparency requirements while recognizing some of the unique aspects of the OTC derivatives markets. The Dodd Frank framework uses many of the already established core principles for designated contract markets ("DCM"s) and ECMs that list significant price discovery contracts. However, in implementing these core principles, the Commission has proposed many prescriptive rules that may hamper innovation in exchange traded swaps. Over the past ten years, as exchanges evolved from mutually owned boards of trade into publicly traded companies, there has been substantial investment and innovation in exchange compliance and market monitoring. This investment and innovation has happened without prescriptive rules or directives from regulatory authorities. The Commission should ask whether the regulatory framework it is building will constrain this innovation by offering only one way for SEFs to comply with rules. In addition, the Commission should keep in mind that the progress in exchange compliance and market monitoring made under the ten years of Core Principles easily exceeds the innovation made in previous twenty-five years of prescriptive rules. Thus, we urge the Commission to exercise restraint and use its rule making authority to address only those discrete issues where it believes specific, binding rules are needed. If additional rules are required based upon review of the markets in operation, they can be promulgated through subsequent rulemakings.

Further, in measuring SEF compliance with applicable Core Principles and CFTC regulations, the Commission should recognize that even the best systems and procedures cannot prevent or necessarily detect every violation or achieve the intended result. Although some of the Core Principles and many of the rules contained in the Proposal require SEFs to "ensure" that certain conduct does or does not occur, or to "prevent" events from arising, the Commission should gauge a SEF's compliance with such obligations by determining whether the SEF has put in place measures that are reasonably designed to achieve compliance with the applicable Core Principle or rule, and not by whether the measures implemented were successful in every instance.

Specific Issues in the Proposal

Indicative Prices

Central to the transparency requirements of Dodd Frank is the requirement that swaps be exchange traded, whether on a SEF or a DCM. Dodd Frank further instructs the SEC and CFTC to "promote pre-trade transparency in the swaps market" while allowing a SEF to offer trading through any means of interstate commerce.[1] The Commission balances these objectives by allowing SEF market participants to execute transactions subject to the mandatory clearing requirement on a central order book or through a Request for Quote ("RFQ") system. Block transactions, transactions not subject to the mandatory clearing requirements or "illiquid products" can be executed by any method, including voice. In addition, the rules allow a SEF to offer market participants the ability to post indicative or non-binding prices.

In adopting final rules for acceptable execution methods, the Commission should clarify that all compliance rules, including disruptive trading practices rules, applicable to firm quotes must apply equally to RFQs and non-firm quotes. Because there is no obligation on the initiator of an RFQ or a non-firm quote to execute at a given price, both can be used, at no risk to the initiator, to influence or manipulate firm quotes and, consequently, traded prices. For example, on January 18, 2011, the U.S. Treasury markets moved from 3.298% to 3.378% in twelve minutes when a trader "fat fingered" an RFQ to sell $6 billion instead of $6 million in U.S. securities.[2] Clearly RFQs for large size that are not executed can still have a pronounced effect on traded prices. Similarly, a trader could use non-firm quotes, at no risk to himself, to more attractively "frame" an otherwise out-of-the-market firm quote. For example, if intrinsic "value" for an illiquid instrument is $13-15, a trader could make his $18 firm offer appear attractive by also showing a $17 non-firm bid and a $21 non-firm offer. The attractiveness of the $18 firm offer could be further enhanced if the $17 non-firm bid was for large size. As these simple examples indicate, it is imperative that the compliance regime around RFQs and non-firm quotes be at least as rigorous as that for firm quotes.

Monitoring of Trading

Core Principle 4 requires that SEFs have the capacity to prevent "manipulation, price distortion and disruptions of the delivery or cash-settlement process through surveillance, compliance and disciplinary practices and procedures" which include real-time monitoring of trading and accurate trade reconstruction capabilities. The Proposal specifies methods and

[1] Dodd-Frank Wall Street Reform and Consumer Protection Act, Section 733. (July 21, 2010)

[2] "Fat Finger" Error Pressures Treasurys, Wall Street Journal, C13 (January 19, 2011).

procedures SEFs must employ in monitoring trading activities within their markets, including general requirements that apply to all swap markets (§37.401), additional requirements that apply to physical delivery swaps only (§37.402), and additional requirements that apply to cash-settled swaps only (§37.403). In this regard, we note that while our market regulation function utilizes both manual processes and automatic alerts to identify potential trading abuses, such processes and alerts cannot prevent all such abuse from occurring.

In addition, proposed regulation §37.401 would impose a requirement that real-time monitoring of trading be conducted to identify intra-day position limit violations. There are several difficulties inherent in trying to monitor positions on a real time basis, including, among other things, the fact that a position snapshot at any time other than end-of-day may be flawed and inaccurate. This is the result of the fact that option deltas change throughout the day, the destination of allocated and give-up transactions are not immediately known, and off-exchange transactions, which may not be reported in real-time, can significantly change the position of a commercial market participant compared to an intra-day position calculation. Although SEFs can attempt to develop systems to monitor positions on a real-time basis, the limitations identified above would impair the accuracy of the resulting position data for a participant at any point in time during the trading day. We believe that currently, the only way to accurately determine whether an intra-day position limit violation has occurred is on the basis of information available on a trade date plus one (T+1) basis. On such date, information regarding the actual positions carried and cleared by the trader the previous day can be accessed to determine if applicable limits were exceeded at a particular time of the day. This is not to say that in the rare case where a trader enters an order or builds an intra-day position of such magnitude that it unquestionably breaches applicable limits, the SEF should ignore it. In such a case, enforcement action can be taken by the SEF under its rules.

The proposed rule also would require that real-time monitoring of trading be conducted to detect "impairments to market liquidity". There is no reference to such "impairments" in the Core Principle, and the Commission provides no explanation or example of what it intends by the use of the phrase. The Commission should delete this phrase from the proposed rule as it is vague and has no foundation in the Core Principle itself.

Proposed rule §37.403 states that, for a swap that is settled by referencing a swap traded on another venue, the SEF must "have an information sharing agreement with the other venue or swap execution facility", or the SEF must "have the capacity to assess whether positions or trading in the swap or commodity to which the swap is cash-settled are being manipulated in order to affect prices on its market." We believe that this proposal places an undue burden on a SEF to monitor positions held at other trading venues. Instead, we believe that the monitoring of positions across different trading venues would more efficiently be facilitated by a central

regulatory body, such as the Commission, which has access to the full extent of position information. Alternatively, the Commission should consider that membership in the Intermarket Surveillance Group (or a similar group) satisfies this requirement.

Proposed rule §37.405 requires that SEFs adopt trading pauses or halts to comply with Core Principle 4. While ICE agrees that trading pauses or halts can be an effective way to prevent a market disruption, they are not the only effective mechanism for achieving this goal. For example, a temporary price floor or ceiling can work better than a pause or halt since trading can continue uninterrupted at the ceiling or floor price, thereby offering the earliest opportunity for price reversal should the market deem a sudden large move to be an overreaction or error. By being prescriptive, the Commission is hindering innovation in developing new mechanisms to prevent market disruptions. The Commission should retain a flexible approach to compliance with Core Principle 4.

Finally, while proposed rule §37.405 requires SEFs to have risk controls, it does not expressly require SEFs to have pre-trade risk checks or controls as the Commission has proposed for DCMs. For SEFs, it is critically important to have adequate pre-trade risk checks or controls, especially if the Commission requires swaps trades to be cleared on an open offer basis. This is why the Pre-trade Functionality Subcommittee of the Commission's Technology Advisory Committee has recommended that all trading platforms (SEFs or DCMs) adopt pre-trade risk checks or controls. Pre-trade risk controls or checks are also important given that a SEF can use an RFQ as a permitted method of execution. The previously referenced RFQ "fat finger" mistake in the U.S. Treasury market[3] could have been prevented by a simple pre-trade risk control. This is especially important in thinly traded markets where RFQs are more common. If the Commission determines not to require pre-trade risk controls for SEFs, it should prohibit SEFs that do not have these risk controls from offering direct access to their markets. A firm with direct access to a SEF that does not have adequate pre-trade risk controls could significantly disrupt a market.

Prohibited Use of Data Collected for Regulatory Purposes

Pursuant to proposed rule §37.7, the Commission prohibits SEFs from using for business or marketing purposes any proprietary data or personal information it receives to fulfill its regulatory obligations. The Commission needs to clarify this rule as it could prohibit some common business practices. For example, can a SEF send a marketing email advertising a new product to its user base? Alternatively, can a SEF create an index using price data it derives from trading on its markets? This is unclear under the proposed rule. The Commission should clarify

[3] Ibid.

the rule by prohibiting use of confidential information it receives for regulatory purposes, such as position data.

Designation and Qualifications of Chief Compliance Officers

Dodd Frank requires that SEFs establish a Chief Compliance Officer ("CCO") position. The legislation establishes duties for the CCO including establishing or administering any policy or procedure to comply with the SEF core principles. Proposed rule §37.1501(b) implements the CCO Core Principle, but goes further. In particular, the Commission requires that a CCO not serve in the legal department or as general counsel of the SEF.[4] In a footnote, the Commission outlines two reasons for this requirement. First, the Commission argues "CCOs must be neutral fact finders…in contrast an entity's general counsel serves as the legal counsel and defender of a company and seeks to avoid or negate related legal risks."[5] What the Commission misses is that noncompliance with the Commodity Exchange Act is a legal risk. Thus, the Commission's reasoning completely undercuts its argument. A general counsel or member of the legal department has a legal duty to ensure that the company they represent complies with the law and arguably is well suited to acting as a chief compliance officer.

The second reason given by the Commission is that "[i]f a SEF's CCO were also its general counsel, much of the information about its compliance program could potentially be protected from third-party review…under the shroud of attorney-client privilege."[6] The Commission's line of reasoning is unfortunate as it undercuts a basic tenet of the U.S. legal system. The purpose of the attorney client privilege is to "encourage clients to make full disclosure to their attorneys"[7] and "is founded upon the necessity, in the interest and administration of justice, of the aid of persons having knowledge of the law and skilled in its practice, which assistance can only be safely and readily availed of when free from the consequences or the apprehension of disclosure."[8] The Commission's proposal appears to undermine this privilege to have access to discussions between the CCO and its company concerning compliance. The Commission's need for these communications is unclear, as the

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[4] The explanatory text to the rule only references that a CCO cannot serve as general counsel. The rule however precludes a CCO serving in the legal department. There is no explanation for this discrepancy.

[5] 76 Fed. Reg. 1214, 1232 (January 7, 2011)

[6] *Id.*

[7] Fisher vs. United States, U.S. 425 U.S. 391, 403 (1976).

[8] Hunt v. Blackburn, 128 U.S. 464, 470 (1888). The Commission has noted the importance of the attorney client privilege as well. See, *e.g.* CFTC Division of Enforcement Advisory Notice on Cooperation Factors (stating that the Division recognizes that attorney client privilege is fundamental to the administration of justice) http://www.cftc.gov/ucm/groups/public/@cpdisciplinaryhistory/documents/file/enfcooperation-advisory.pdf

Proposal contains no discussion of this topic. In any event, a SEF is likely to waive privilege to allow the CCO to discuss the SEF's compliance with the Commission's regulations. However, the Commission should not prohibit an attorney from serving in this role in order to undercut attorney-client privilege. Therefore, the Commission should drop the requirement that the CCO cannot be the general counsel or a member of the legal department.

Compliance with Rules

Core Principle 2 requires, among other things, that a SEF establish, monitor and enforce its rules, including those relating to access requirements, and have the capacity to detect and investigate potential rule violations and sanction any person that violates its rules. Proposed rule §37.203 would require investigative reports that are presented to disciplinary panels to include the respondent's entire disciplinary history at the SEF. Unless the rule violations that are the subject of the investigative report involve pervasive record-keeping violations, we would suggest that only substantive violations in the respondent's history would be relevant to the panel's deliberations and that burdening the record with a history of record keeping infractions is not necessary.

In addition, proposed rule §37.203 prohibits a SEF from issuing more than one warning letter for violation of the same[9] SEF rule. This unnecessarily restricts SEF compliance staff, especially when considering trivial or inadvertent violations of SEF rules. In particular, this rule could discourage market participants from self-reporting violations of exchange rules given that SEF compliance staff may not have any discretion in determining whether to access a penalty. ICE suggests that the Commission take a more flexible approach, if a SEF abused its discretion, then the Commission can cover that issue in a rule enforcement review.

Conclusion

We appreciate the opportunity to comment on the Proposal. Please do not hesitate to contact the undersigned at (770) 916.7832 or trabue.bland@theice.com if you have any questions regarding our comments.

[9] The Commission uses same and similar in the footnote to the Proposal. We suggest that if the Commission adopts this rule, it use the term "same."

Sincerely,

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and Assistant General Counsel
IntercontinentalExchange, Inc.