Intercontinental Exchange

ICE NYSE

# Energy & Environmental Markets Advisory Committee
# Panel II

February 26, 2015

# Why the Need for Change?

- Since 2012, all of ICE's U.S. energy contracts have traded as futures

- Any disruptions will only harm End-Users
  - Markets composed of energy companies
    - **70-80% of OI held by commercial companies**
  - Model convergence
    - **Futures and cash converge within less than one penny**

- Rules must accommodate unique nature of energy contracts
  - Single and all-month limits will squeeze liquidity and harm hedging out the curve
  - Deliverable supply must be updated and realistic
  - Longstanding commercial hedging practices are critical
    - Cross Commodity
    - Unfixed Price Purchase and Sales
    - Anticipatory

# Market Regulation's Process

To ensure markets operate efficiently:

- We take in A LOT of data:
  - Audit Trail
  - Position Data
  - Cash Market Fundamentals
  - Weather Reports
  - News Feeds
  - Social Media: Twitter, Message Boards
  - Trade practice/position limit violations
  - Futures/Cash price divergence
  - Volume Alerts
  - Price Alerts
  - Liquidity Drainage
- Use data to identify market stress indicators
- Understand how participants operate and utilize the markets

# Single and All-Month Accountability vs Limits

- Intended to manage positions or concentrations of positions out the curve
  - Never intended to be real-time protections
  - Analytical based outcomes require the consideration of multiple factors

- Intended purpose can be accomplished with accountability levels
  - Exchange can take no immediate action but maintain dialogue
  - Require that participant not increase position further
  - Require that participant reduce position

- Existing accountability regime works
  - Considers multiple factors that cumulatively determine if a position should continue to be carried – 10, 2.5 formula is not the answer
  - Must be applied proactively
  - Must have an open dialogue with the participant

# Deliverable Supply Estimates

- Spot month limits must be based off of current and realistic estimates of deliverable supply

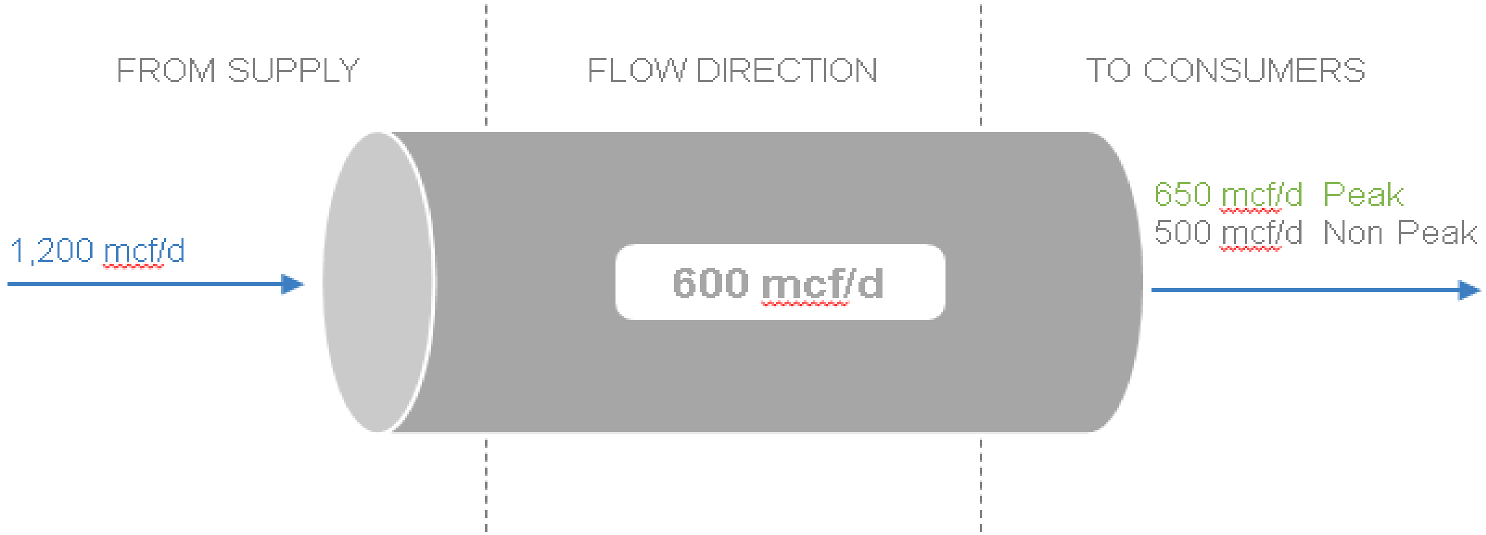
- A one size fits approach does not work
  - Energy markets greatly differ from agricultural futures and the same principles should not be applied

- Natural gas and Power infrastructure is interconnected by design, deliverable supply must take this into consideration

- Natural Gas estimates should be based on the volume of gas that can be transported to fulfil demand

- Power estimates must recognize the transmission of generation from other areas

# Deliverable Supply Estimates




- Hypothetical Example
  - Supply of 1,200 is greater than the pipeline capacity of 600
  - Demand of 650 on heating days is greater than capacity
  - On non-heating days the excess capacity can be used to store gas for future sale when demand spikes otherwise the pipeline can operate at less than full capacity
  - Regardless of the season or conditions, pipeline capacity represents the quantity that is readily available

# Bona Fide Hedges

- Bona Fide Hedging definition is too narrow

- Fails to recognize longstanding commercial practices as legitimate hedges
  - Cross commodity
  - Anticipatory
  - Unfixed price

- Threatens prudent risk management decisions and will harm liquidity

- Exchanges should be permitted to grant these exemptions based on thorough review
  - Demonstration that the risk reduces commercial risk
  - The exemption level is economically equivalent to the risk
  - The exemption level is appropriate for the participant and the market

# Forward-Looking Statement and Legends

CAUTIONARY STATEMENT REGARDING FORWARD LOOKING STATEMENTS

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