INTERCONTINENTAL EXCHANGE/TRAYPORT MERGER INQUIRY

Summary of hearing with Broker A on 1 June 2016

Background

1. Broker A is a broker responsible for operating a regulated venue. Broker A stated that it used Trayport as a software provider for its platform for dealing in energy markets.

Broker A on Trayport

2. Broker A stated that it licensed Trayport's Broker Trading System (BTS). All of Broker A's clients either had direct screen connectivity to its platform or used the Trayport Trading Gateway aggregator. Broker A also used Trayport's hosted clearing link, which allowed access and trade submission from Broker A's BTS via the hosted clearing link into multiple clearing venues that Trayport had connectivity to.

3. Broker A stated that it managed the software it licensed from Trayport. Broker A was free to add products – the financial instruments Broker A would like to be traded or arranged on their platform – onto its platform.

4. Broker A stated that it used the Trayport technology primarily for price dissemination, ie to get its prices out in front of all of the clients who were connected to Trayport. The Trayport system also provided Broker A with a reference point for its own internal voice-brokers. Broker A also pointed out that ICE venue prices were also disseminated over the Trayport software in the same way.

5. Broker A stated that its role was to arrange for two parties' orders to be placed together to allow them to arrange a trade. Broker A arranged for the full execution of the trade by passing it to the exchange.

6. Broker A stated that it had the ability to arrange trades off-exchange, however, this was limited to 'block' futures trades. Block size trade rules were set by each exchange and block sizes differed by product type; anything under block trade size must be executed directly on an exchange venue. Broker arranged block futures needed to be registered with the exchange for execution within 5 to 15 minutes of the agreement being struck.

7. Broker A stated that these timescales came in when the block rules were put in place, and previously these timescales had not been a requirement.

8. Broker A stated that block trades were a growing element of the market as exchanges were launching products in more asset classes. Currently, some asset classes had a greater proportion of block trades than others but they were growing in all asset classes. Oil and coal products already had a very high rate of block futures across different exchanges, whilst block trades were becoming more common in gas and power markets.

Broker A on alternatives to Trayport

9. Broker A stated that EFETnet provided a platform with similar functionality to the hosted clearing link provided by Trayport, although there may be differences in features such as the range of clearing houses that each had access to. [✂].

Broker A on ICE

10. Broker A stated that ICE was an exchange venue where liquidity accumulated. In that sense, Broker A believed that both ICE and Trayport were means by which liquidity was disseminated to the marketplace, and so they could be considered to be comparable. However, Broker A pointed out that Trayport sold itself as a technology solution to a regulated market.

11. Broker A stated that traders used ICE and Trayport as two different venues they could trade on, it was the traders' choice which platform they chose to execute on and hence where liquidity gathered in a particular market.

12. Broker A stated that it competed with ICE for execution of trades.

Switching between voice trades and electronic trades

13. Broker A stated that in mature markets, such as gas, the market had moved on from being a voice-trade based system and was now an electronic medium. This was highlighted as traders could quote a price using voice trading and would sometimes not receive a response, however, putting the same price on screen would often result in a trade. Most of the energy markets were now screen focused.

14. Broker A stated that most, but not all, of the products where Trayport was active were now screen-based products. Broker A expected that those products which were not screen-based would move to a screen-based system in time as it was the way that the market liked to be serviced. In those markets

where Trayport was active, the market was very reliant on the Trayport technology to get prices out to their customer base. However, there were some markets, such as oil, which remained primarily a voice-based market. These markets had yet to embrace screen-based trading.

15. Broker A stated that the choice of voice trading or electronic trading was all related to the breadth of the customer base - the liquidity in the market. In more mature markets, traders had been used to trading electronically using Trayport. Trayport was the platform which had the largest customer base - the largest liquidity - so traders would look for customers/liquidity on Trayport. However, in some markets, such as oil, this had not happened.

16. Broker A stated that the benefits of the Trayport technology system were that it focused market liquidity in one place onto one screen, in contrast to voice broking which was generally a bi-lateral process.

17. Broker A stated that voice brokers brought value to some trades. If a client had a trade which was large or multi-legged, or complex, then they would tend to lean towards using a voice-broker; whereas, for a pure ‘vanilla trade’, a client was unlikely to pay a premium to use a voice-broker.

18. Broker A stated that in some products, clients were prepared to pay a premium to see liquidity focus in one area on one screen, so, for a small price rise, say 10%, in Trayport prices, clients were unlikely to move away from using Trayport where the liquidity was in the market.

19. In relation to the level of competition between over the counter (OTC) brokers and exchanges, Broker A stated that it had seen a shift in liquidity on national balancing point gas from OTC trading to trading on ICE’s exchange. Broker A indicated that it believed some OTC market players could not access the whole market and had moved to ICE to gain that liquidity.

20. Broker A stated that all customers could potentially switch between OTC and exchange execution. It also considered that it was feasible that the volumes executed OTC but not cleared could shift to exchange trading and potentially ICE.

Competing for clearing services

21. Broker A stated that the trader generally determined the exchange venue on which the broker executed and cleared the arranged trades.

22. Broker A stated that most trades were cleared in the energy markets, even those that were executed off-exchange.

23. Broker A stated that traders did not use just one clearing house, but there could be efficiencies if they polarised business into one central counterparty clearing house (CCP) to enjoy cross-margin benefits.

Choice of clearing venue and ease of switching

24. Broker A stated that for a new product which was currently not cleared to be available for clearing, then first and foremost ICE/Trayport would have to offer the product for clearing and then connect the Trayport system to the clearing house to be able to offer that product to the cleared product either by its own venue or via Trayport. Trayport created an electronic liquidity pool for brokers that could complement or compete against the liquidity pool that exchanges provided to the marketplace. If the two liquidity pools acted in the same way, that is, were equally efficient, then brokers could act in the market. If the liquidity pools did not act in the same way and the exchange liquidity pool was more efficient than the broker liquidity pool, then the brokers would lose out. Efficiency meant depth of liquidity.

25. Broker A stated that electronic trading captured deals and could feed these directly into the clearing house. Electronic trading could also present a number of side benefits, such as regulatory reporting. Broker A explained that a clearing venue would value capturing as many potential clients as possible, so would seek to have its services available to as wide a pool of clients as possible.

26. Broker A stated that if Trayport was owned by a clearing house then it would be in Trayport's best interests to increase the client base available to this clearing house and channel as many clients towards that clearing house as possible.

27. Broker A stated that ICE had now allowed Trayport to develop connectivity to the ICE CCP. Previously ICE had not been prepared to allow this connectivity.

28. Broker A stated that previously, ICE appeared to have been focused on attracting clients to its own WebICE platform where it offered ICE products for ICE clearing. This would optimise the power of its clearing to capture both the execution and clearing and then be able to market its associated services.

29. Broker A stated that ICE could widen its client base post-merger by launching new products which it was not currently clearing, especially if it was trading via or being arranged via the Trayport software as a venue.

30. Broker A stated that the fear was that ICE would prevent (or delay) new CCPs from having post-trade access to Trayport, reducing the opportunity of new competition in the clearing space for the products which were on Trayport.

Concluding remarks

31. Broker A emphasised that it would be very important for clearing houses to have the same level of access to Trayport execution as ICE itself had in order to enable effective competition in the clearing space in Europe.

32. Broker A stated that with the market moving more towards an increasing proportion of trades being cleared, partly as a result of regulation, that ICE could have an increasing value proposition from clearing fees than from execution fees. Broker A believed that it may be that those execution venues that did not have clearing venues would find it more difficult to compete in the future.