INTERCONTINENTAL EXCHANGE/TRAYPORT MERGER INQUIRY

Summary of hearing with Tradition Financial Services Limited on 8 June 2016

Background

1. Tradition Financial Services Limited (Tradition) said that it licensed Trayport's Broker Trading System (BTS) and its hosted clearing links.

2. Tradition said that it was first established as a broker in 2000 in the oil market. It said it subsequently moved into coal, emissions and German power – and in the preceding seven years its energy trading had grown exponentially under the direction of its current CEO.

Competition and the clearing process

3. Tradition said that approximately three years ago Trayport ceased supporting their deployed clearing links as clearing functionality was moved to software as a service (SaaS) managed entirely by Trayport. Tradition said that prior to this they managed the Trayport deployed clearing service with each exchange in-house. SaaS was a subscription based service managed externally by Trayport that served to map products between brokers and the clearing houses for the purpose of submitting trades for clearing.

4. Tradition said the main difference between the two systems was that with SaaS it had no direct connection to the clearing house and was dependent on Trayport's mapping service provided by their support team. It said there were no commercial costs to brokers for using SaaS as Trayport charged exchanges and clearing houses.

5. Tradition said that the quality of service provided by Trayport was slower than that of its in-house team using the previous deployed clearing link system as Tradition now had to email Trayport to map new products.

6. Tradition said that it understood Trayport's other broker clients were also moved onto SaaS. It said that the Trayport's clearing system's full functionality was only available if clients moved to SaaS, as the old system that permitted in-house management of the clearing process became non-functional.

7. Tradition said all of its new customers were assigned to Trayport's SaaS, with all the relevant data being supplied to Trayport to set it up.

8. Tradition said that it was possible to build its own alternative to Trayport's hosted clearing; however it would lack the technical functionality and efficiency expected by traders when compared to Trayport's product. It said for an efficient STP process, any clearing link would need to send the trade for clearing at the point of execution and feedback any reference data. It said this was only possible with Trayport's compatible clearing service.

9. Tradition had considered eXRP as an alternative, but had chosen Trayport's SaaS because eXRP did not have the capability to write the clearing status back into the Tradition BTS due to the closed architecture of Trayport's software. It said Trayport's read-only closed API prevented Tradition enriching trades with additional data from third party clearing services such as providing an update to traders when its products had cleared.

10. Tradition said not all exchanges offered the same over the counter (OTC) cleared markets and that Tradition offered a choice of execution across OTC and multiple exchanges, which helped liquidity and transparency in the market. It said traders' choice of clearing house was partly driven by cost, cross-margining and available liquidity.

11. Tradition said traders favoured using STP links because it provided a quick automated service. Tradition still offered a manual clearing service for clearing houses not connected via STP. Tradition said that traders would be more concerned with their overall exposure and positioning than the actual method of clearing. It said that margining and clearing was also typically handled by a risk department, rather than traders.

12. Tradition said that ICE's lack of an STP link had not, historically speaking, impeded it from gaining market share in particular markets. It said that it did not consider an STP link as a strict requirement for other firms to expand. Tradition said that as an example it used ICE Block software, which required manual clearing, and that it had turned off the STP link for CME cleared coal.

OTC and Exchange Trading

13. Tradition said that the original differences between OTC brokers and exchanges no longer held true. It said that originally OTC brokers traded bespoke forward contracts for physical settlement; whilst exchanges traded futures, a standardised version of a forward contract traded electronically and cash settled. It said that both OTC brokers and exchanges now traded

standardised products electronically and could deliver physically, and thus offered a more similar service than was previously the case.

14. Tradition said a major difference between OTC brokers and exchanges was that OTC markets required bilateral credit agreements between counterparties, whereas exchanges did not require bilateral credit as the clearing house was the counterparty to each transaction.

15. Tradition said that brokers provided a price-discovery service for its customers and created liquidity by working with customers to agree on mutually acceptable market prices. It said this contrasted with exchanges where prices were entered and matched purely electronically and without manual intervention or negotiation. Tradition said that brokers' role in a trade was completed once execution was finalised, and that brokers were not involved in the settlement of traded products as the physical delivery was organised by the two parties involved.

16. Tradition said there was no fundamental barrier that would stop volumes moving freely between an exchange and OTC brokers in certain markets. It said that the emissions market was a good example of how liquidity could shift. It said that the carbon market had shifted from being traded almost entirely OTC to on exchange. It said this was due to reported VAT fraud known as the VAT carousel and stolen carbon credits in the OTC market. Along with the standardisation of the product and its annual maturity, made it an easy product to migrate. The UK Gas market (NBP) is another example of an OTC energy product migrating from the bilateral market to on exchange, with over 50% traded volume now being executed on an exchange.

17. Tradition said there were exceptions to its view of the possibility of shifting liquidity across trading venues. It said that OTC financial coal products were always cleared post trade, yet were entirely negotiated and traded via OTC brokers. It said there was no specific reason for this anomaly or why coal trading did not migrate to an exchange. Only that the market in general, perhaps by trader's choice, had no appetite to shift the liquidity.

18. Tradition said that over the preceding three years exchanges had increasingly offered physical settlement of products. It said exchanges expanded their services due in some respects to a lack of interest in new financially cash-settled markets and high demand from utility traders for physically settled products without counterparty risk of default.

19. Tradition said that it saw all other exchanges as its' competitors with regards to execution services. However, competition between OTC brokers and exchanges for the execution of trades did not deter brokers developing

relationships with exchanges to offer clearing services for OTC products. It said that exchanges sought to develop revenue in whichever trading venue liquidity resided.

20. Tradition said that the future of an OTC brokerage was to provide access to a selection of clearing houses. In this respect providing choice of execution across the OTC and cleared markets from a single pool of liquidity. It said this service was not available when executing through one exchange as a trader must typically clear with an exchange's clearing house partner. It said that as markets became more liquid, standardised, and transparent – the easier it was for liquidity to migrate from brokers to an exchange, therefore OTC brokers were always looking to diversify into underdeveloped markets.

MiFID II and regulatory changes

21. Tradition said that REMIT and the Markets in Financial Instruments Directive (MiFID II) had the potential to force small brokers and trading companies out of the energy market because they may not have the requisite resources for regulatory compliance. It said an effect of regulations might result in reduced liquidity.

22. Tradition said REMIT had imposed significant costs on its business. It said it was forced to change its own record keeping and had to report every order to a regulator on a daily basis. Tradition said its parent company had an entire department focussed on MiFID II and compliance.

23. Tradition said that according to MiFID a product traded on an exchange for physical delivery was categorised as a financial derivative and came under regulations. It said some parties were introducing an alternative to the multi-lateral trading facility (MTF) model, thereby enabling the physical settlement of products on an exchange without it being categorised as a financial derivative for purposes of MiFID compliance.

Competition and ICE/Trayport products

24. Tradition said that it considered itself in competition with ICE, along with all other exchanges, for providing execution services. It said ICE made its revenue from exchange trading fees, plus it's separate technology and data service businesses and Tradition from OTC brokerage, but that each party perceived its market position as under threat from the other in terms of execution.

25. Tradition said that the technology used by brokers had not been updated by Trayport for a long period of time, whereas the technology used by traders

had seen a great deal of investment. It said that ICE's acquisition of Trayport could risk a further deterioration in the technology it relied on or in fact the technology might actually improve if ICE sought to enhance Trayport's offering by updating the software in line with its own advanced WebICE platforms.

26. Tradition said it was contractually prevented from distributing real-time price data outside of Trayport's software due to its closed API. It said ICE's acquisition of Trayport could permit it to extend current restrictions to prevent Tradition from providing data to third parties.

27. Tradition said that if a rival to Trayport was to emerge, trading venues would be deterred from using it due to Trayport's closed API. It said Trayport's closed API would not grant a rival read/write access to its system. It said if the two rival platforms could not communicate, then trades could not be updated to signal they had been sold between different front/back end platforms. It said therefore products would have to be listed on one or the other, but not both, as it could lead to duplication. It said as a result trading venues would be prevented from executing products on both platforms interchangeably, effectively forcing liquidity onto one.

28. Tradition said previous entrants that challenged Trayport, such as Elysian Systems, could not attract the required liquidity as trading venues were prevented from displaying its prices outside of Trayport's closed API. It said for similar reasons Tradition could not display its prices on alternative ISVs such as Trading Technologies or Exxeta front-end screens.

29. Tradition said pre-merger ICE and Trayport were perceived as competitors by traders and alternatives for execution. It said that as an example ICE had partnered with Griffin Markets to provide technology to compete against Trayport, but had failed to shift liquidity. It said that the competition between ICE and Trayport was over screen real estate and network, plus the available liquidity, not the technology itself.

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31. Tradition said that when Trayport was owned by GFI it developed an additional feature called Join-the-Trade (JTT) to which GFI had exclusive access. Tradition said this was justified by Trayport by claiming that it was providing GFI with bespoke technology that it paid to develop. Tradition said that Trayport reasoned they were providing GFI with the same opportunity offered to all customers, that is, to pay for bespoke feature development. Tradition said this approach upset the market because it appeared to represent Trayport's lack of neutrality under GFI ownership. Tradition said

ultimately the JTT feature had no impact as demand among trading venues was minimal.

Concluding Remarks

32. Tradition said the main risk it faced as a result of the merger was renegotiating its Trayport licensing contract with ICE. It said ICE, in some respects, was its competitor and that Tradition might be faced with higher fees and greater contractual restrictions on sharing data with third parties. Tradition said that any exchange owning the Trayport technology would have an incentive to reduce competition from brokers or rival exchanges.