

INTERCONTINENTAL EXCHANGE/TRAYPORT MERGER INQUIRY

Summary of hearing with CME Group on 17 June 2016

Background

1. CME Group said that it was an exchange operator that operated a number of exchanges in the US: CME, the CBOT, NYMEX and COMEX, all of which cleared at CME Clearing Inc. NYMEX was CME's energy exchange. CME was a recent entrant in Europe with CME Europe and CME Clearing Europe, established about two and five years ago, respectively.
2. CME Group listed over 1250 energy products across energy asset classes globally. CME said that the European utilities products were relevant in the context of Trayport, including European gas, European power, international coal, and emissions.
3. CME Group said that it had its own matching engine, Globex, which was an electronic trading platform that CME used for all their products worldwide. Globex provided an open access application program interface (API) which allowed any independent software vendor (ISV) to write directly to it. [X].
4. CME Group said that its clearing interface was ClearPort which also had an open API approach. Platform providers, such as Trayport, had also written directly to ClearPort and that this was effectively their straight through processing (STP) link.
5. Customers also had access to Globex and ClearPort through a free front-end distribution platform, CME Direct. CME Direct only provided access to CME Group products and CME Group operated exchanges and it was used almost exclusively in the US. CME Direct was not used for European utilities products. For the distribution of European utilities products, CME Group relied entirely on Trayport.

CME Group on clearing and execution

6. CME Group said that trades were cleared as exchange futures or OTC block futures. Once cleared with CME Group they were an exchange contract under the exchange rules.
7. CME Group said that there were many ways that a broker could submit a trade for clearing. For example, if the broker agreed to submit that trade to

clearing with CME Group, the broker could submit that trade to CME Group for clearing by fax, by email, or he could call it in using CME Group's facilitation desk. However, brokers were more likely to use an electronic platform which was written directly to the interface, such as Trayport's STP link. The broker could submit the trade via the Trayport clearing link, or do the same via a similar clearing link on CME Direct. It was the broker's choice how he preferred to submit it on behalf of the trader.

8. CME Group said that in relation to European utilities products, CME Group's European utility products were available for exchange trading. Clients could trade them on Globex, however, CME Group did not have any meaningful distribution specifically in European utility products. It said the dominant screens in the market were WebICE and Trayport. Neither WebICE nor Trayport provided access to Globex. CME Group said that Trayport provided access and connectivity to ClearPort, meaning that this was the avenue CME Group had available for distribution. So whilst the volume reported by CME Group was technically in exchange contracts, they result from activity in the OTC space.
9. [✂].
10. [✂].
11. CME Group said that every derivative, including every energy derivative, product was different even when products referred to the same underlying index. There were some very unique and distinct characteristics associated with derivatives products for commodities, e.g. different regulated exchanges, different clearing locations, liquidity in each market was different, customers' open interests were different, and bids and offers in the market would also be unique, which bid-ask among other things result from the underlying liquidity of the product.
12. CME Group said that for vanilla products, which were identical, then the main differences between products was liquidity, open interest and the number of clearing firms associated with the product. Other factors could also be the total number of market participants and the distribution.

CME Group on Trayport

13. CME Group entered into an initial agreement with Trayport for connectivity, through the STP clearing link, in 2011.
14. CME Group said that when CME Group connected ClearPort to Trayport, Trayport wrote the interface between the two systems. At that time there

wasn't any client demand on Trayport's side to write to CME Group. CME Group decided that, [REDACTED]

15. CME Group said that, as part of a [REDACTED] deal, CME Group pays Trayport [REDACTED]. CME Group said that [REDACTED]. CME Group said that their agreement [REDACTED]. CME Group said that normally [REDACTED].

CME Group on competition between ICE and Trayport

16. CME Group said that competition between WebICE and Trayport depends on whether the products on each screen were similar enough to meet the same needs of the Trader.
17. CME Group said that it believed that, historically, both ICE and Trayport viewed themselves as competitors. Even though they were offering different types of software solutions and Trayport provides the market with full access to all products – both WebICE and Trayport were competing for the same customers.
18. CME Group said that there was a rivalry between ICE trying to convert the market from broker bilateral markets on to pure exchange traded markets, and away from the brokers. CME Group said that, in their view it will be difficult for all energy products to move completely to exchange trading, because of their complex nature and the number of idiosyncrasies of each of the different products. Consequently, there will be a need for brokers to facilitate bilateral negotiations of these products.
19. CME Group said that Trayport clients had been asking for access to ICE Brent for many years and Trayport had been unable to negotiate access. [REDACTED].
20. CME Group said that owning the distribution gives a business a competitive advantage.
21. [REDACTED].
22. CME Group said that it was difficult to say whether traders would in reality switch as long as the only place that traders had to switch to was owned by the same company. In addition, if CME Group clearing was not accessible on the other platform, then that was not an ideal outcome.

CME Group on clearing

23. CME Group said that Trayport's main value was not just in providing aggregation but goes beyond that. Trayport provided access to the entire life

cycle of a trade, i.e. price discovery, trade agreement, and trade submission. CME Group's only serviced on Trayport clearing trades through the STP link. CME Group's role was to begin once a trade had been made, but in order for the trade to be agreed the traders will first need to had seen the bids and offers on that price for a CME block. The value for market participants was having access to the entire life cycle of a trade in one place. If there was no price discovery, there will likely be no trade agreement and trade submission, including for clearing to CME Group.

24. CME Group said that if market participants were disadvantaged as a result of the merger, traders wouldn't have had any alternative to ICE and Trayport in relation to European energy products. If traders wanted to discipline ICE by not using ICE/Trayport, they would had to go back to trading on voice, which they would be very reluctant to do.
25. [✂].
26. CME Group said that there were a number of factors that will influence a traders' choice of where they clear a product. There was the ease and efficiency of using an STP link. CME Group said that there was also: the overall margin; the margin offsets that were available to the trader; and the total liquidity in that specific product. In addition, traders will consider the price and whether there were any incentive programmes available. CME Group said that, in addition, traders will also consider other soft factors, such as what was the level of service provided.
27. CME Group said that the most significant factor was liquidity; [✂]. CME Group said that once a trade was done, a broker would find it easier to submit it to clearing on a pop-up screen on their desktop rather than either logging onto a separate website and entering it in, or, phoning the clearinghouse with details of the trade. Without seeing the prices on the screen then trading would had to revert to trading via voice.
28. CME Group said that brokers had a number of alternatives to placing their trade with a clearing house other than using Trayport's STP link: using the CME Group website, email, telephone or fax can all be used. [✂]. However, there were risks associated with these alternative routes, for example traders need to have had trades cleared by a certain time because of block trade price reporting requirements. CME Group said that even if trades were not submitted through the Trayport STP link, almost 100% of the OTC trades in relation to European utilities products cleared by CME Group were trades where price discovery and trade agreement occurred on Trayport.

29. CME Group said that in order to compete for clearing, exchanges firstly needed to have the right products, that was, a product that provided the risk management profile clients needed to hedge their risk exposure. Exchanges also needed to have distribution, that was the right clearing firms connected to a clearing house and distribution in order to get those products out to the right market participants. Once the products were distributed, then competition will take place over overall capital efficiencies, including margins, fees, costs and overall service levels. However, poor service, such as the clearing links going down much more frequently than they used to, would lead to a drop in the volume of business that would be put through CME products. [✂].
30. [✂].
31. CME Group said that Trayport could decide to [✂].

CME Group's coal clearing products

32. CME Group said that its NYMEX coal cleared CME Clearing Inc product, was part of a US regulatory environment, with different liquidity provisions and which attracts different clearing firms as compared with ICE's coal products. CME Group built liquidity in its coal product when it entered with a coal product and ICE's coal volumes remained flat. [✂].
33. CME Group said that it was more difficult to switch liquidity between products than it might be to create new volumes with a new product.

CME Group on regulation

34. CME Group said that the REMIT carve out for energy products in relation to MiFID II was the first time that regulation clearly specifies that the physical trading activity had to take place on organised trading facilities (OTF). Physical products had to be physically delivered, could not be netted, and had to be traded through an OTF. Effectively, what Trayport was today was a software provider for non-MTF platforms and the expectation in the market was that the non-MTFs will become OTFs. A physical market participant, in Europe, with *bona fide* physical hedging requirements, will want to continue trading in the same way as they were today via an OTF. This was critical to how market participants in Europe will be conducting their business going forward.

CME Group on launching new products

35. [✂].

36. [REDACTED].
37. [REDACTED].
38. [REDACTED].
39. [REDACTED].
40. [REDACTED].

CME Group on the trend towards exchange trading

41. CME Group said that, for example, coal today was traded almost exclusively via brokers on Trayport. Traders of coal products had historically said that they do not want exchange trading of coal products, even though exchange trading of coal products was available for free on WebICE.
42. [REDACTED].
43. [REDACTED].
44. CME Group noted that since Trayport and ICE historically viewed themselves as competitors, much like ICE had had certain incentives to not include certain of their products on Trayport, Trayport had an incentive not to list some ICE products. [REDACTED].
45. [REDACTED].

CME Group on the sale of Trayport to ICE

46. [REDACTED].
47. [REDACTED].

CME Group on the development of an alternative to Trayport

48. CME Group said that there had been no shortage of plans to develop an alternative to Trayport. There had been ongoing initiatives, but no one had been able to do it yet. [REDACTED]. Successfully developing a new system will be very difficult but there were a few guiding principles that an alternative distribution platform would had to satisfy.
 - (a) Open API: The reason Trayport was so successful in its distribution was that the only way to get access to its back-end software was to buy the front-end, which was typically not the way trading software companies

work. Other ISVs do not also supply a back-end matching engine. As such, the closed API was a unique feature of Trayport. In order to develop an alternative to Trayport, CME Group believe that you need to have an open API.

- (b) CME Group estimated that the cost to build an alternative from scratch would be roughly [✂]. It would probably take at least [✂] to build, distributing it might take a bit longer.
- (c) CME Group estimated that in order for it to be successful, almost all of the market participants would need to switch away from Trayport on to an alternative at the same time.