30 January 2015

Fair and Effective Markets Review
Email: FEMR@bankofengland.co.uk

Dear Sir/Madam

"How fair and effective are the fixed income, foreign exchange and commodities markets?" Consultation document October 2014

We are writing to respond to the Fair and Effective Markets Review ("FEMR" or "the Review") consultation document[1] on behalf of ICE Futures Europe ("IFEU" or "the Exchange") ICE Clear Europe ("ICEU" or "the Clearing House") and ICE Benchmark Administration ("IBA"). All three companies are subsidiaries of Intercontinental Exchange Inc., ("ICE") which is one of the largest operators of exchanges and clearing houses in the world.

We welcome the Review and share its objective of ensuring that fixed income, commodity and currency ("FICC") markets operate fairly and effectively. We would note, however, that FICC markets are in the main global and therefore international cooperation with regard to regulatory standards and supervision is essential.

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ICE is a leading provider of market infrastructure for FICC markets in the UK and internationally. Our contracts serve customers around the world in interest rates, credit derivatives, energy derivatives and soft commodities. IBA operates the benchmarks for LIBOR and ISDAFIX and will shortly take over the operation of the London Gold Fix (to be renamed the LBMA Gold Price).

Our response to the Review

Our response to the detailed questions included in the Consultation Document is set out in the Appendix.

We have set out below, some general observations on the Review.

Exchange-traded derivative markets are fair and effective

Exchange-traded derivative markets have operated, and continue to operate well. They enable market participants to trade at competitive prices and allow the ultimate end-users to undertake investment, funding, risk transfer and other transactions in a predictable fashion, underpinned by robust infrastructure. They continued to provide liquid, transparent price discovery even at points during the financial crisis when liquidity and credit in some OTC markets had dried up.

[1] "How fair and effective are the fixed income, foreign exchange and commodities markets?" Consultation document, October 2014 (http://www.bankofengland.co.uk/markets/Documents/femr/consultation271014.pdf)

ICE Futures Europe, Recognized as an Investment Exchange under the Financial Services & Markets Act 2000.
VAT Registration No. 577 5972 74
Registered in England No. 1528617
Registered Office: Milton Gate, 60 Chiswell Street, London EC1Y 4SA

ICE Futures Europe
Milton Gate
60 Chiswell Street
London EC1Y 4SA, UK
phone +44 (0)20 7065 7700
fax +44 (0)20 7638 4964
online www.theice.com

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Regulators' powers are either sufficient or are being enhanced

Over the period since the financial crisis, financial markets have undergone extensive regulatory review resulting in substantial legislative and regulatory reform at national and international levels. Full implementation of these reforms has not yet concluded. Since many FICC markets are global, many market participants have had to take into account the regulatory changes not just of the jurisdiction in which their activity is based, but the changes taking place in other jurisdictions.

And these regulatory responses are comprehensive. In the US, the 2,300-page Dodd Frank Act requires many new rules and mandates. The CFTC alone has now finalized 69 rules, exemptive orders and guidance actions and five other actions. In Europe, the regulatory response has been based on the European Market Infrastructure Regulation ("EMIR") and the Markets in Financial Instruments Directive II/Regulation ("MiFID II/MiFIR"). On 19 December 2014, ESMA published its final technical advice to the Commission on MiFID II/MiFIR together with a consultation paper and detailed Regulatory Technical Standards. These regulatory measures address many of the issues covered by the Review and market participants are actively engaged in the process of reviewing and responding to the Regulatory Technical Standards issued by ESMA.

European market structure will be changed by MiFID II/MiFIR

We do not believe that it is necessary or appropriate to make further changes in market structure beyond the substantial and far-reaching changes being considered in the context of MiFID II/MiFIR. Indeed, we view some of the forthcoming structural changes in Europe with concern as they are taking concepts developed in cash equity markets and deploying them in FICC markets to which they are not well-suited. Some of the measures under MiFID II/MiFIR will have impacts on the structure of exchange-traded derivative markets that currently work well with likely unintended consequences.

A number of structural changes in cash equity markets have themselves had such unintended consequences. The fragmentation of execution in the US equity markets, which has also been seen in Europe, has not necessarily resulted in improved overall results for market users, while adding complexity. For example, the so-called 'Reg NMS' in US cash equity markets was intended to create equality of opportunity in the US stock market but has caused the US equities market to become more complex and fragmented. There is a risk that the MiFID II/MiFIR extension of access rules to exchange-traded derivatives could artificially fragment liquidity, weakening regulatory oversight while imposing higher costs on end users.

UK benchmark regulation is proportionate and progressing

We have welcomed the development of UK benchmark regulation, both in respect of the Wheatley review and the regulation of LIBOR and the more recent extension of benchmark regulation proposed by HM Treasury in its consultation paper. ICE is actively involved with the development of this regulation through IBA which already administers LIBOR (currently the only specified benchmark) and ISDAFIX (which will be a specified benchmark from April 2015) and will administer another benchmark to which the Review proposes to extend regulation, the London Gold Fix (to be renamed the LBMA Gold Price). The ICE Brent Index will also become a regulated benchmark.

The development of benchmark regulation has quite properly been a regulatory priority as it is in this area that the principal adverse impacts on the ultimate end-users have been concentrated. The UK regulation will need to be carefully implemented to avoid creating conditions in which firms are deterred from participating in price formation processes.

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It is also important that the forthcoming EU Benchmark Regulation adopts an approach consistent with that pioneered in the UK and in particular does not seek to broaden its scope to areas where inappropriate benchmark regulation might have an adverse impact on liquidity.

International regulatory coordination needs to be improved

Our principal concern in respect of the development of regulation for FICC markets is international regulatory cooperation. The initial objectives of post-crisis regulation were both aligned with the so-called "G20 Commitment", to encourage electronic trading and central clearing of OTC derivatives. But there have been significant divergences in approach between the EU and the US in particular. For example, the EU broadened the scope of regulation beyond OTC derivative markets to include exchange-traded derivatives. This has led to regulations which impose different margin standards on the same instruments depending whether they are cleared in the EU or the US. These and other EU-specific developments are likely to have an adverse impact on the international competitiveness of Europe's wholesale financial services industry in general and on the position of the City of London in particular. International regulatory arbitrage could lead to unnecessary fragmentation of what are naturally global markets.

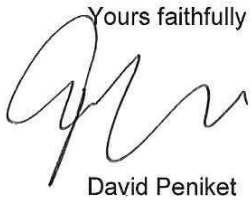
We urge regulators in the UK, the EU and the US to focus on how better to enhance regulatory cooperation, not in order to seek to develop a one-size-fits-all regulatory mandate, but to ensure that on those areas where there is a real risk of regulatory arbitrage a common global minimum standard emerges. IOSCO is well-placed to take the lead here but needs greater support from regulators and policy-makers in key jurisdictions.

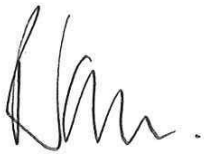
Supervision and market conduct standards can be further enhanced

Market conduct issues remain a significant concern; we have set out in Appendix A our comments on how supervision and market conduct standards might be further enhanced. Further enhancement of education in market conduct and ethics remain a priority. This must be a primary concern for the management of firms, supported by effective supervision, training, remuneration and assessment.

We are grateful for the opportunity to comment. We would be happy to discuss any aspect of our comments with the Review team if that would be of assistance.

Yours faithfully





David Peniket
President & COO
ICE Futures Europe

Paul Swann
President & MD
ICE Clear Europe

Finbarr Hutcheson
President
ICE Benchmark Administration

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Appendix

Set out below are responses to Questions contained in the Review. We have not addressed Questions 3, 6-9, 19, 20, 28, 29, 31 and 39.

What does 'Fair and Effective' mean for FICC markets?

Q1: The Review would welcome respondents' views on the definition of 'fair and effective' FICC markets proposed in Section 3. Does it strike the right balance between safeguarding the interests of end-users without unnecessarily impeding the effectiveness of FICC markets? Are the concepts of transparency, openness and equality of opportunity appropriately specified? And how does the definition compare with those used in other markets, jurisdictions, organizations or legislation?

Effective FICC markets should work for the benefit of both their participants and the wider economy in delivering effective risk transfer and management and in sending meaningful price signals. To this end, effective FICC markets are an essential underpinning of the non-financial economy.

The definition of 'fair and effective' set out in Section 3 is a reasonable one.

Transparency is a function and manifestation of open, liquid and widely available markets with trading between participants with widely divergent economic goals on opposite sides of the market, pursuing objectives in different time frames. As the Review notes, there is an ongoing debate about the extent to which it is appropriate to mandate particular levels of pre and post-trade transparency in the context of MiFID II/MiFIR. In some circumstances, measures to mandate particular levels of pre-trade transparency could have an adverse impact on market liquidity and the interests of end users.

As the Review notes elsewhere, a number of FICC markets are largely professional in character, so while open access is a sensible objective in many cases, a number of FICC markets will not be appropriate for retail investors.

For UK Recognised Investment Exchanges, the principle of a 'fair and orderly' market is an important one. It is set out both in UK legislation implementing MiFID FCA handbook requirements for exchanges (REC) and in the rules of exchanges. It will remain of central importance under MiFID II, and therefore, as recognised in Section 3.3 of the consultation document, care should be taken to ensure that other priorities, such as transparency and open access, do not erode this key supporting principle. It is also widely enshrined in market practice in other major jurisdictions, for example in the United States.

The concept of "market effectiveness" is less widely-used as many markets have evolved organically, without a single top-down design. There is extensive literature on market efficiency, much of it based on the efficient market hypothesis.

A framework for evaluating fairness and effectiveness

Q2: Of the six themes identified in Table A on page 5 (market microstructure; competition and market discipline; benchmarks; standards of market practice; responsibilities and incentives; and surveillance and penalties), which do you consider to be the most important factors contributing to the recent series of FICC market abuses? In which other areas do you believe the fairness and

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effectiveness of FICC markets globally may be deficient? Do these answers vary across jurisdictions, or specific markets within FICC? Are there any other important areas of vulnerability that are not identified in the table?

Most recent regulatory issues have arisen in relation to benchmarks and in the over-the-counter markets.

In the case of benchmarks this was either because the level of supervision of such benchmarks was relatively low - either because their operation was outside the regulatory perimeter or because regulators did not see their supervision as a priority.

In certain OTC markets, transparency is limited, liquidity is fragmented and price discovery more difficult to achieve. Some such markets operate without the framework of rules and regulatory oversight which underpin exchange-traded derivatives.

Market microstructure

Q4: Does the market microstructure of specific FICC markets — including trading structures, transparency, asset heterogeneity or market access — enhance or diminish fairness and effectiveness? Where there are deficiencies, will recent or in-train regulatory or technological changes improve the situation, or are further steps needed? How do these answers vary across jurisdictions, or specific markets within FICC?

The move towards greater trading on transparent, centrally-cleared venues has enhanced fairness and effectiveness in a range of fixed income markets, including interest rate and energy derivatives.

A large number of regulatory initiatives are now under way, notably MiFID II/MiFIR in Europe. This is addressing a range of structural reform and conduct issues. While we do not believe that all of the measures proposed under MiFID II/MiFIR are appropriate, the scope is broad, and the key issues of market structure and access have been addressed.

We view some of the forthcoming structural changes in Europe with concern as they are taking concepts developed in cash equity markets and deploying them in FICC markets to which they are not well-suited given the many differences between how the cash and derivatives markets operate.

A number of structural changes in cash equity markets have themselves had unintended consequences. For example the so-called "Reg NMS" in US cash equity markets was intended to create equality of opportunity in the US stock market but has caused the US equities market has become more complex and fragmented. There is a risk that the extension of concepts developed in cash equity markets to FICC markets could lead to similar fragmentation.

In fixed income:
Q5: Is greater use of electronic trading venues for a wider range of market participants possible or desirable? Are there barriers preventing a shift to a more transparent market structure?

Greater use of electronic trading facilities is possible for those fixed income products in which trading interest is either concentrated at particular liquidity points during the trading day or is continual in nature. Use of transparent, electronic trading facilities – whether to facilitate price discovery through periodic auctions or continuous trading – generally enables broader participation in the price formation process, leading to enhanced liquidity and more robust outputs which are less susceptible to improper influences.

However the characteristics of some fixed income products do not easily lend themselves to electronic

trading. This is because trading in some fixed income products – particularly options contracts - tends to be spread over a large number of expiry months and series making it diffuse in nature. In consequence, trading in any one series tends to be sporadic and "lumpy", rather than being relatively continual. For example, ICE Futures Europe currently lists over 800 series in the standard Euribor Option and maintains a separate market for each of these series in order to be able to match like bids and offers. Added to this, two-thirds of the volume of options business is accounted for by strategy trades (a separate market for each strategy type in respect of the relevant combination of series must be created, again to ensure that like bids and offers are matched). Given the diffuse nature of activity in these contracts, ICE Futures Europe has appointed Designated Market Makers ("DMMs") to provide competitive two-way prices and order sizes. The DMMs can choose whether to quote through the central order book or over the telephone. In practice, most DMMs quote over the telephone, on request, due to the size and complex nature of the strategies being used in the options markets and in order to avoid being exposed to the significant risk which would arise from quoting the entire options complex on-screen.

In commodities:
Q10: Are there any material barriers preventing greater transparency in OTC commodity derivatives markets? If so, what could be done to remove them?

In energy derivative markets, liquid exchange-traded benchmarks are complemented by a large number of OTC derivative contracts. The energy market is well-served by a number of price reporting agencies ("PRAs") who developed in response to demand for accurate price information. PRAs publish thousands of prices on a daily basis, and have a vested interest in publishing independent, reliable numbers.

Over time, a number of OTC energy derivatives which were previously transacted between counterparties or via voice brokers have started to trade on screen. For example, the Dutch TTF natural gas market is now predominantly screen-traded even though the bulk of the activity continues to be bilaterally-settled.

Given the number of regulatory initiatives currently under way we do not propose any additional steps at present. The IOSCO Principles for Oil PRAs are working well, and PRAs and their users are best placed to assess the effectiveness of such processes in relation to the tens of thousands of such prices produced as market reference prices.

Regulatory measures:
Q11: Are there any areas of FICC markets where regulatory measures or internationally co-ordinated regulatory action are necessary to address fundamental structural problems that exist?

Structural issues in FICC markets have been or are being addressed by the UK and EU benchmark regulation and by the initiatives arising from the G20 Commitment[2] to encourage electronic trading and central clearing of OTC derivatives.

There is now a greater need for international regulatory cooperation, since there are a number of material inconsistencies between, for example, the regulation that has emerged from the Dodd Frank Act in the US and EMIR and MiFIDII/MiFIR in the EU. If these kinds of inconsistencies are not addressed we anticipate that customers are likely to migrate some trading activity between jurisdictions. The International Organization of Securities Commissions ("IOSCO") is well-placed to assist with the identification of those areas where inconsistencies have arisen and where the risk of regulatory arbitrage needs to be mitigated. A key example of such a conflict is the imposition of different margin standards on

[2] "All standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end-2012 at the latest. OTC derivative contracts should be reported to trade repositories." G20 Leaders Statement, the Pittsburgh Summit, 24-25 September 2009.

the same instruments depending on whether they are cleared in the EU or US.

Conflicts of interest and information flows

Q12: Where do potential conflicts of interest arise in the various FICC markets, and how do they affect the use and potential abuse of confidential information, both within and between firms?

On the basis of the evidence of FCA disciplinary cases over the last two years, a failure to manage conflicts of interest has been shown to have contributed to the occurrence of misconduct by some firms in the following markets such as inter-bank money markets (e.g., LIBOR) and spot-foreign exchange.

A review of the disciplinary cases reveals the following common themes in the way in which conflicts of interest were exploited by some firms:

- they engaged in inappropriate use or disclosure of confidential information, either within the firm or with others;
- weaknesses in market mechanisms enabled them to act upon such information in order to exert undue influence within such mechanisms. They did so by attempting to influence a rate or fixing in one market, which was used for determining financial obligations in other markets in which the firms in question were also active; in contrast, many other participants in the second market were not active in the first market and had no practical means of protecting themselves against the undue influence; and
- the control framework and culture within the firms in question proved inadequate to prevent such conduct.

These issues could be addressed as follows:

- enhancing or replacing the existing market mechanisms by incorporating appropriate checks and balances to make them less susceptible to attempted manipulation, for instance by introducing a greater degree of independence, scrutiny, objectivity or transparency (this is already in progress in relation to LIBOR);
- improving the training on market conduct issues which is provided to front-office staff, within the context of the creation of industry-led codes of conduct and good practice; and
- enhancing compliance monitoring within firms, coupled with the greater use of preventive measures.

Q13: How can the vulnerabilities posed by such conflicts be reduced? Are existing internal structures and control procedures sufficient? Where they are not, are further internal management controls required (such as better trading floor design and/or closer monitoring of electronic communications within and between firms) or is more radical action required to remove conflicts altogether?

See answer to Question 12.

Q14: Is there a relationship between the level of competition in FICC markets globally and the fairness and effectiveness of those markets? What risks are posed by the increase in concentration seen in some FICC markets? In answering this, please have regard to the geographical scope of any relevant markets.

There is a relationship between the level of competition in FICC markets globally and the fairness and

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effectiveness of markets in some respects; in general, for any given market, the broader the level of market participation, the higher the level of liquidity and the quality of price discovery. Greater pooling of activity improves liquidity and leads to tighter spreads and better prices for participants.

Regulators need to be mindful of the risks to participation and liquidity of imposing additional capital and reporting burdens on market participants.

Promoting effective competition through market forces

Q15: To the extent that competition is currently ineffective in any of the FICC markets, are there market-led initiatives, technological or structural changes that may remedy this situation?

ICE's markets are subject to highly competitive conditions. ICE competes with CME/NYMEX, LCH, Nasdaq and other groups for liquidity and volumes.

A number of FICC markets have developed successfully over the last 20 years as a result of competition that is facilitated by changes in technology. For example, many energy markets are now electronically traded, and a range of energy derivatives are now cleared following competition between ICE's clearing solution and NYMEX's Clearport offering (now owned by CME Group).

ICE has spurred the development of competition in clearing in London through the creation of ICE Clear Europe, the first new derivatives clearing house in London for over 100 years. London now has four derivatives clearing houses and competition between them is increasing.

Further market-led initiatives will develop over the coming years as technology continues to advance and a trading community that is used to voice-broked markets is replaced by a generation that has grown up with the internet and electronic trading.

Q16: Are there any lessons that can be drawn from experiences in other financial markets (or indeed other markets) about the ways that alternative or evolving market structures could impact on competition in FICC markets?

There is currently an active debate in the US about the structure of its cash equity markets. Well-intended regulation in the 1990s (the so-called "Reg NMS") had a series of unintended consequences including the fragmentation of liquidity, less transparency and greater overall costs for market participants. The lesson to be drawn is that the best solutions to market structure issues are those that are developed by entrepreneurs in response to market opportunity; and that artificial market designs imposed by regulators risk creating as many problems as they solve.

Q17: How effective is market discipline in enforcing sound market practices in each of the key FICC markets? What could be done to strengthen it?

Please see the answer to Question 4.

Promoting effective competition through regulatory and legislative initiatives
Q18: In what ways might competition in any of the key FICC markets usefully be addressed by competition authorities (e.g. by assessing the state of competition in relevant markets)?

Competition authorities should only intervene where there is evidence of anticompetitive behaviour/conduct. This is not the case in the current structure of FICC markets, which are highly competitive. A number of new entrants have begun providing services in FICC markets in recent years

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and there is vigorous competition between different market infrastructure providers.

It is because of ICE's ability to compete strongly with other exchange and clearing infrastructure providers that ICE has been successful. This is principally due to two factors: ICE's willingness to compete on the one hand, and on the other a national and international regulatory environment, which has long supported this kind of global competition. Our competitors have shown a similar appetite to compete, which has brought benefits to the marketplace as regards innovation and connectivity. In turn, the global nature of derivatives markets is something that the G20 acknowledged as an asset.

Benchmarks

Q21: Do current domestic and international initiatives by industry and regulators to improve the robustness of benchmarks go far enough, or are further measures required?

Domestic and international initiatives developed by industry and regulators are sufficient. The UK benchmark regulation provides an effective framework for the enhancement of LIBOR. The Review has already identified seven additional benchmarks to be brought into the scope of the UK regulation and we believe that this measure is appropriate. It will be important, however, to ensure that the regulation of the additional benchmarks does not unintentionally deter companies from participating in price-formation processes. The FCA could reduce this risk by providing clearer guidance on benchmarks without submitters. The EU is currently considering benchmark regulation although it is currently unclear to what extent and when jurisdictions beyond the EU will implement the CPSS/IOSCO standards on benchmarks.

Industry-level measures

Q22: What steps could be taken to reduce the reliance of asset managers and other investors on benchmarks?

Benchmarks are used by asset managers and other investors because they fulfil a useful function. They are vital to allow investors of all sizes to gauge the performance of their investments and fiduciaries. Benchmarks are also well understood by end users as a fair way of measuring performance of particular sectors or assets. The policy focus should be on improving the oversight and effectiveness of existing benchmarks rather than moving the market away from them altogether.

Q23: What additional changes could be made to the design, construction and governance of benchmarks?

IBA is overseeing a review of LIBOR and the development of the so-called "LIBOR plus". Other benchmarks, such as the London Gold Price, are being similarly enhanced. We believe the new UK benchmark regulatory framework provides an appropriate template for the development of benchmark regulation in the EU and globally. It is important that this remains proportionate, however, and we do not believe that it is in the interests of market participants or end-users to extend such regulation to large numbers of prices, e.g., in physical commodity markets.

Q24: Should there be an industry panel to discuss benchmark use and design with the aim of assisting industry transition?

Multiple market, institutional and informal panels and institutions have already evolved. No new structures are needed.

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Regulatory action
Q25: What further measures are necessary to ensure full compliance with the IOSCO Principles for financial benchmarks by all benchmark providers?

IOSCO is already in the process of reviewing the implementation of the Principles for Financial Benchmarks in relation to individual benchmarks. It has undertaken extensive work in this regard and has published comprehensive and detailed reports containing its reviews of LIBOR, EURIBOR, TIBOR and the WM/Reuters London closing foreign exchange spot rate. The reviews of the "IBORs" have found that all of the benchmark administrators have made significant progress in implementing the majority of the Principles, while noting that further work is needed in some areas in order to ensure full compliance.

For each of the benchmarks concerned, IOSCO has also announced that it will conduct a follow-up review by the middle of 2015 in order to assess progress with addressing outstanding issues. ICE believes that IOSCO should be permitted to continue with its important work in this area, without other authorities duplicating its efforts.

Q26: How can the regulatory framework provide protection to market participants for benchmarks administered in other jurisdictions in a proportionate way?

The purpose of the IOSCO Principles for Financial Benchmarks is to promulgate a set of agreed international standards which are applicable to all such benchmarks. This approach has been adopted because usage of a benchmark, by its very nature, is generally not confined to a specific jurisdiction, but is global or regional in nature. As such, individual jurisdictions should refrain from introducing additional measures or requirements which are incompatible with the IOSCO Principles. Such measures would merely serve to balkanize business and would undermine the significant efficiency and network benefits which are facilitated by unimpeded access to a well-functioning benchmark.

Standards of market practice
Q27: Are existing sources of information regarding standards of market practice across FICC markets globally:
(a) already sufficiently clear (or will be once current regulatory reform has concluded); (b) sufficient, but in need of clearer communication or education efforts; or
(c) not sufficiently clear, requiring more specific guidance or rules to provide more detail or close genuine gaps?

Information about the standards and requirements in particular FICC markets varies, depending on the manner in which the particular market is organised and the regulatory environment in which it operates. FICC markets which operate under the auspices of a Recognised Investment Exchange, such as ICE Futures Europe, are subject to a set of objective and publicly-available Rules, Trading Procedures and guidance documents, which clearly articulate standards of acceptable conduct and detailed requirements for the negotiation and execution of business on the market concerned.

Q30: How can the industry, firms and regulators improve the understanding of existing codes and regulations by FICC market participants and their managers?

Industry associations can play a useful role in providing practical written guidance concerning the application of regulatory requirements and standards to participants in particular markets. To do so effectively, such associations will need to liaise closely with the relevant regulatory authority to ensure that the guidance is an accurate and reliable reflection of the regulatory authority's interpretation of the regulatory requirements and standards concerned.

Can the industry help to establish better standards of market practice?
Q32: What role can market codes of practice play in establishing, or reinforcing existing, standards of acceptable market conduct across international FICC markets?

Please see the answer to Question 30.

Q33: How would any code tackle the design issues discussed in Section 5.4.3, i.e.: how to ensure it can be made sustainable given industry innovation over time? How to differentiate it from existing codes? How to give it teeth (in particular through endorsement by regulatory authorities or an international standard setting body)? How to communicate it to trading teams? Whether, and how, to customise it for individual asset classes?

An appropriate balance would need to be struck between the development of over-arching principles and more detailed commentary about conduct which is and is not acceptable. This should help to reduce the extent to which regular updating is required, whilst recognising that no written code or guidance can cover the specifics of every scenario which may arise. In many cases, firms will need to exercise judgement in considering how the principles within the code or guidance apply to a particular scenario that they face. To do so, they will need to include relevant staff in front-office, legal and compliance functions in order to ensure that novel scenarios are handled appropriately.

In contrast, where a particular market has undergone, or is undergoing, significant structural changes (e.g. a move from a phone-broked environment to an electronic trading environment) the written guidance or code would need to be reviewed and updated by the industry association in question, in liaison with the relevant regulatory authority.

Should the scope of regulation be extended?
Q34: In the context of implementing MiFID 2, which of the FCA Principles for Businesses should apply in relation to MiFID business with Eligible Counterparties?

MIFID II requires investment firms which have clients who are categorised as Eligible Counterparties to act honestly, fairly and professionally and to communicate with them in a way which is fair, clear and not misleading.

Communication with clients is covered by FCA Principle for Business 7, which is expressed in the same terms as the MIFID II requirement. In contrast, the MIFID II requirements of acting honestly, fairly and professionally have no direct analogue in a discrete FCA Principle for Business. Instead, those requirements are elements of a number of individual FCA Principles for Business, for example Principle 2 (Skill, care and diligence) and Principle 6 (Customers' interests). As a result, it may be necessary to sub-divide a number of the FCA Principles for Business in order that the relevant elements of them can be applied to customer relationships with Eligible Counterparties.

Q35: Are there any financial instruments that should be brought more fully into the scope of regulation in order to improve the fairness and effectiveness of specific FICC markets? For any instruments proposed: (a) what protections does the current framework provide; (b) what gaps remain of relevance to fairness and effectiveness; and (c) what is the cost/benefit case, bearing in mind the Review's Terms of Reference as set out in Section 1? Responsibilities, governance and incentives.

In December 2014 HM Treasury announced that seven additional FICC benchmarks (including the ICE Brent Index, Gold and the WM/Reuters 4.00 pm London Closing Spot Rate) will be brought within the

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scope of the Financial Services Act 2012 and MAR 8 which already apply to LIBOR[3]. At present, there is no compelling case to extend the regime further. Nonetheless, the scope of the regime should be subject to periodic review, on the basis of the selection criteria set out in the FEMR team's report to HM Treasury.

Q36: How much of a role did inadequate governance, accountability and incentive arrangements play in the recent FICC market abuses, and to what extent do these remain potential vulnerabilities in FICC markets globally?

These were all significant factors in the enforcement cases which have been brought by the FCA in relation to LIBOR, Gold and spot foreign exchange. They would be most effectively analysed through a review of disciplinary cases and addressed through implementation of the measures which are described in the answer to Question 12 above.

In addition to on-going regulatory changes, what further steps can firms take to embed good conduct standards in their internal processes and governance frameworks? And how can the authorities, either internationally or domestically, help to reinforce that process, whether through articulating or incentivising good practice, or through further regulatory steps?

Given the extensive changes to regulatory requirements which have been, or are being, introduced as a result of EMIR, MIFID II and UK and EU Benchmark legislation, at this stage there is little more that should be done in legislative terms. Instead, the emphasis should now be on the development of complementary initiatives which can foster the observance of best practice within the FICC markets.

For example, industry associations can play a useful role in providing practical written guidance, and developing codes of conduct, concerning the application of regulatory requirements and standards to participants in particular markets. To do so effectively, such associations will need to liaise closely with the relevant regulatory authority to ensure that the guidance is an accurate and reliable reflection of the regulatory authority's interpretation of the regulatory requirements and standards concerned. As such, ICE would encourage the FCA and its counterparts in other jurisdictions to stand ready to support industry efforts to promulgate practical guidance and effective codes of practice upon which individual firms and their staff can rely.

Firm-wide initiatives to improve incentives and governance
Q37: Do respondents' agree that the thematic areas highlighted in Section 5.5 are key priorities for FICC firms (fine-tuning performance measures; adjustments to remuneration; attitudes towards hiring, promotion and advancement; closer board involvement in governance of FICC activities; and clearer front line responsibilities)? What specific solutions to these challenges have worked well, or could work well? And how best can the authorities help to support these initiatives?

A number of the thematic areas identified in Section 5.5 could be included in industry codes of conduct or best practice.

Market wide initiatives to align market conduct, incentives and governance
Q38: To what extent could the Banking Standards Review Council help FICC market participants to raise standards collectively — in particular, are there other steps that could be taken to help complement or extend this initiative in FICC markets for non-banks and internationally?

Whilst the launch of the Banking Standards Review Council ("BSRC") is a welcome initiative in the

[3] Further to the Fair and Effective Markets Review: Recommendations on Additional Financial Benchmarks to be Brought into UK Regulatory Scope.

promotion of best practice within the banking industry, it remains in the early stages of development. The BSRC's first Chairman, Dame Colette Bowe, only took up her role on 1 November 2014 and the BSRC's initial report on banking standards and good practice will not be published until mid-2015. It is therefore premature to determine whether or not the specific BSRC model should be applied to non-banks.

Industry codes do have a significant role to play in improving standards of conduct across the FICC markets (as explained in our answers to Questions 30 and 33).

Q40: What role can more effective surveillance and penalties for wrongdoing play in improving the fairness and effectiveness of FICC markets globally? How can firms and the industry as a whole step up their efforts in this area? And are there areas where regulatory supervision, surveillance or enforcement in FICC markets could be further strengthened?

As a Recognised Investment Exchange, ICE Futures Europe already engages in extensive market monitoring and surveillance. It has disciplinary powers to levy fines and suspend access, which are used on occasion and where necessary. As a benchmark administrator, IBA also monitors the efficiency of the price discovery process.

More effective surveillance has a role in improving the effectiveness of FICC markets globally. Many firms have significantly enhanced their efforts in this respect in recent years. As a Recognised Investment Exchange, ICE Futures Europe engages with many firms in FICC markets as we help to ensure compliance with our rules. There is still a significant divergence between the best and worst performing firms and the industry would benefit from the development of market standards in respect of surveillance, systems and controls. This could be assisted by the development by industry-led 'good practice statements' in these areas, against which firms could assess themselves.

For the purposes of deterrence and prevention, we believe that, rather than modifications to the available penalties, the greater priority should be effective enforcement in FICC markets by regulatory authorities.

Firm level surveillance

Q41: How can firms increase the effectiveness of their own surveillance efforts across FICC markets globally? What role could the industry play in helping to explore best practices on how to make whistleblowing and other similar regimes more effective? Is there scope to make greater use of large scale market data sets and electronic voice surveillance to help detect cases of abuse in FICC markets? Are there other potentially effective tools?

As described above, the industry would benefit from the development of a series of 'good practice statements' in relation to surveillance, systems, controls and market conduct. In our experience, most firms are keen to ensure that their surveillance and compliance efforts are of the highest quality, but on occasions it can be difficult for senior management easily to determine how firms compare with their peers. On many questions in this area - for example, the management of conflicts of interest - a range of views might reasonably be taken and firms would benefit from a forum jointly to explore these kinds of issues.

Large scale market data sets can be of value, and ICE Futures Europe routinely analyses order and trade data in order to detect a number of abuses. In some cases it can be difficult for firms to detect inappropriate behaviour since information may only be available to regulators who can see both sides of trading activity. The suspicious transaction reporting regime is potentially valuable but the overwhelming number of reports now received by the FCA provides a practical problem for the regulator in identifying those cases which need to be pursued and those which are false positives.

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Firm level penalties

Q42: Are there processes or structures that can allow firms to punish malpractice by their own staff more effectively (for example, penalties for breaching internal guidelines)?

It is usual for breaches of internal policies and/or procedures (e.g. compliance manuals) to amount to disciplinary matters for employees - in the worst cases being gross misconduct where penalties could include dismissal.

Q43: Could firms active in FICC markets do more to punish malpractice by other firms, for example by shifting business and reporting such behaviour to the authorities?

As set out in response to Q40 above, a Recognised Investment Exchange, ICE Futures Europe already engages in extensive market monitoring and surveillance. It has disciplinary powers to levy fines and suspend access, which are used on occasion and where necessary. As a benchmark administrator, IBA also monitors the efficiency of the price discovery process.

Firms are already required to report suspicious transactions to the FCA without delay (a suspicious transaction is one in which there are reasonable grounds to suspect it might constitute market abuse, such as insider dealing or market manipulation). In addition, under the Proceeds of Crime Act 2002 and the Terrorism Act 2000, suspicious activity reports (SARs) must be made to the National Crime Agency concerning suspected proceeds of crime (i.e. money laundering and terrorism). We understand the reporting of inappropriate behaviours has increased; so far a limited number of these cases has resulted in disciplinary action.

Regulatory level surveillance and supervision

Q44: Is the current supervisory approach and level of intensity dedicated to supervising conduct within the UK wholesale FICC markets appropriate?

The current supervisory approach has been constrained by the level of resources available to the FCA and the understandable and appropriate focus on dealing with the regulatory issues arising from the financial crisis.

Going forward, the approach would benefit from an emphasis on the prevention of inappropriate conduct, both through the development and dissemination of good practice standards and through effective front-line supervision and monitoring and early contact with firms and traders where inappropriate conduct is detected.

Q45: Are there ways to improve the data on FICC market trading behaviour available to the FCA, whether through the extension of the regulatory perimeter or otherwise?

Transaction reporting to the FCA (and other National Competent Authorities within the EEA) will be extended with the implementation of MIFID II to all financial instruments which are admitted to trading on a trading venue, financial instruments where the underlying is a financial instrument traded on a trading venue, and financial instruments where the underlying is an index or a basket composed of financial instruments traded on a trading venue[4].

In addition, the FCA already has access to extensive information about the basis for LIBOR setting by

[4] Article 26(2), MIFIR (Regulation (EU) No. 600/2014).

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virtue of the regime established under the Financial Services Act 2012 and MAR 8 (Benchmarks) of the FCA Handbook. Moreover, in April 2015, seven additional FICC benchmarks (including ICE Brent, Gold and the WM/Reuters 4.00 pm London Closing Spot Rate) will be brought within the scope of the Financial Services Act 2012 and MAR 8[5]. The FCA also has wide-ranging information-gathering powers.

As a result, the FCA should have access to sufficient information – either directly from firms or via trading venues or benchmark administrators – about relevant activity in key FICC markets.

Regulatory-level penalties

Q46: What further steps could regulators take to enhance the impact of enforcement action in FICC markets?

A recent focus of FCA enforcement action in FICC markets has been on those cases arising from the financial crisis and its aftermath, particularly in respect of the manipulation of benchmarks such as LIBOR. ICE Futures Europe cooperates closely with the FCA in respect of potential enforcement cases in the FICC markets it oversees, and reports suspicious trading activity noted during market surveillance.

We would make the following observations:-

- Supervisory/enforcement cooperation between the United Kingdom (e.g. the FCA) and the United States (e.g. the CFTC) is, in our experience, good, and regulators work closely together in respect of those cases with implications both for the US and the UK.
- Cooperation with some other jurisdictions can be more complicated particularly where legal regimes are not aligned, and confidential communication channels agreed and operative.
- Further, while confidentiality arrangements around investigations and/or enforcement actions are rightly in place; this can constrain cooperation and delay/prevent supervisory intervention with firms and/or the giving of appropriate firm specific, or industry guidance.
- Interactions between regulatory/crime prevention agencies (e.g. where market abuse overlaps with financial fraud) can add to the complexity of cooperation, causing further delay etc. Greater clarity around the responsibilities of market infrastructure, firms and the respective regulatory/crime prevention agencies would therefore be beneficial.
- Cross-border enforcement action is complex and can therefore be slow, with uncertain outcomes.

Q47: Should consideration be given to greater use of early intervention, for example, temporary suspension of permission for a particular trading activity for firms or individuals or increased capital charges?

In dealing with abuses such as market manipulation, prevention is generally more effective than cure. Not only does it stop other market users suffering the consequences of the abuse, it also avoids the need to prove that market abuse has taken place (which can often be difficult). However, prevention may best be achieved by effective supervision/monitoring followed by early contact with the firm concerned to warn them that if their conduct were to continue or intensify, it would become the subject of a formal investigation. This is to be preferred to increasing capital charges (which should be a tool for managing financial risk, not market conduct) or suspending regulatory permissions (which would, quite properly, entail a high burden of proof, and should be subject to due process).

[5] Fair and Effective Markets Review: Recommendations on Additional Financial Benchmarks to be Brought into UK Regulatory Scope.

Q48: Is there a need to widen and or strengthen criminal sanctions for misconduct in FICC markets?

The criminal sanctions available to the authorities are already extensive. Rather than creating additional ones, ICE believes that the UK authorities should consider how better use could be made of the powers which already exist, both in day-to-day supervision, as well as enforcement.

Q49: Is the approach set out in the Criminal Sanctions Market Abuse Directive appropriate for the United Kingdom? Are there additional instruments or activities to those envisaged by the Directive that should be covered by the domestic criminal regime?

ICE understands that the UK Government has decided not to opt into the EU Criminal Sanctions Market Abuse Directive ("CSMAD")[6], but that the future criminal regime in the UK will be at least as strong as CSMAD. This implies that the future UK criminal regime may be broader in scope than CSMAD. However, the scope of CSMAD is itself broad – covering market manipulation (whether by placing orders, entering transactions or disseminating information), manipulation of benchmarks, insider dealing (including recommending and inducing), unlawful disclosure of inside information, inciting, aiding and abetting market manipulation and insider dealing, and inchoate offences. This seems to be a comprehensive list of offences. Moreover, the fact that CSMAD covers manipulation of a benchmark means that its reach is not limited to activity which has an impact on financial instruments that are admitted to trading on a trading venue.

[6] Directive 2014/57/EU.