09-Feb-2016

Intercontinental Exchange, Inc. (ICE)

Credit Suisse Financial Services Forum

CORPORATE PARTICIPANTS

Jeffrey Craig Sprecher
Founder, Chairman & Chief Executive Officer

MANAGEMENT DISCUSSION SECTION

Unverified Participant

So we'll get started with our next presentation. I'm very pleased to welcome back Intercontinental Exchange to the Credit Suisse Financial Services Conference. With me on stage is Chairman and CEO, Jeff Sprecher. So welcome Jeff, and thanks for making it down to this conference again.

Jeffrey Craig Sprecher
Founder, Chairman & Chief Executive Officer

Yeah. Thank you, [ph] Christian (00:19).

QUESTION AND ANSWER SECTION

Q

So really a good place to start off is just with the broader macroeconomic environment, I mean you're still at the heart of some of the most topical markets today, be the equity market or the commodities markets. So curious as to your perspective in terms of what's driving the current market turbulence.

Jeffrey Craig Sprecher
Founder, Chairman & Chief Executive Officer

A

Well, it's – mainly that's the volatility that we're seeing, which really drives hedging activity and trading activity. And as you mentioned, we see it in like almost all the primary markets where we're doing business. So New York Stock Exchange itself probably in the fourth quarter was the best quarter in the company's history and the month January was probably the best January in the company's history in terms of its revenue and earnings. And so, that's obviously coming from the volatility of stock trading, but also the consumption of data and the capital raising that's going on around listings and the primary function of exchange to raise capital.

And then similarly, we have a footprint in energy, a large footprint in energy. And as you can imagine with oil price volatility, which is what the headline product is, but we have everything that comes out of a barrel of oil. It's all equally as volatile. And so, all of those products are tremendous training activity.

And then we're very large in European interest rates and with all of the conversation around Central Bank policy, particularly as it relates to the ECB and in Europe and speculation about what the bank may do, it's driving volatility. So we do see a highly volatile market that's generating a lot of revenue for us, but is causing our customers to take action with their risk management positions.

Q

And so, I guess, turbulence is for good business, but there are also other opportunities for you in terms of the growth in your market data and the non-volumetric part of your business.

Jeffrey Craig Sprecher
Founder, Chairman & Chief Executive Officer

A

Right.

Q

So as you look on into 2016 and beyond, I guess what most excites you in terms of growth going forward?

Jeffrey Craig Sprecher
Founder, Chairman & Chief Executive Officer

A

Well, in that part of the space, we've seen probably almost three years of organic growth in consumption of data. I think a lot of it is – first of all, you and I as individuals, ourselves are consuming a lot of data. We have a smartphone most likely in our pocket and it's getting more and more information than we ever possibly imagined we would walk around with. And that same trend is happening on a macro level in risk management.

If you couple that with the growth in passive investing, the exchange traded funds and other kinds of passive products that consumers are really up taking right now, all of those consume data and they need indices and real-time marks, if you will, for investors to have the transparency that they need.

So in total, we just see a lot of growth in the subscription-based kind of service that we have that's providing data. We've been exploiting that by building a lot of new products, new indices. We just announced in last few weeks that BlackRock was going to build some of its larger fixed income ETFs around index portfolio that we're providing to them. AllianceBernstein is going to take some of our real-time data now to use in having better oversight and a view into their execution quality in the fixed-income space. We continue to sell a lot of commodity data. I think there's just a lot of interest right now and users trying to figure out whether to lock in these oil prices, manage their existing hedging portfolio, lot of lenders that have loans, that are tied to the energy space and commodity space that are trying to hedge using the commodity prices.

So in total, it's just incredibly exciting time to be in that business, because it just looks like there's a lot of organic growth, particularly if you can execute well, which a lot of my colleagues are doing a good job of.

Q

So I guess, you brought up the two every interesting opportunity that you mentioned, you announced recently in terms of AllianceBernstein and BlackRock. Maybe just give us a bit more detail in terms of how those opportunities emerge? Were you proactive in trying to get that? And then, as you think about the broader opportunity set, that M&A from those two opportunities, how do you think about those?

Jeffrey Craig Sprecher
Founder, Chairman & Chief Executive Officer

A

Well, we're in a luxurious position with the New York Stock Exchange, that the bulk of U.S. based exchange traded products are listed on and trade on NYSE on our Arca platform. And so, we have a group that specializes in that and has the relationship with large passive asset managers. We also have inside the NYSE was a hidden asset that we found in there was a calculation engine that we used to calculate the value of these exchange-traded products in real time, so that we can provide transparency and that there can be marks in there.

When we bought Interactive Data Corporation, which has fixed income assets, they had been building a real-time fixed income calculator. So we pushed those two groups together, so that we really now have the ability to do debt and equity in real-time calculations.

And the relationships that we had with people like BlackRock to really – discuss with them the opportunity to use some of our new products and for those that aren't following that because we have a lot of active managers in the audience here, but that passive space is highly competitive. And, if you are going to enter that space – if a new entrant was going to enter that space, you really have to enter with an interesting product and that's probably a new index, some portfolio of stocks and bonds that is uniquely organized and that may be weighted in different ways using some kind of, what they call, smart data weighting and it's going to need infrastructure to help do calculations and it's going to need data that you can go back test this portfolio, so that you can talk to perspective investors about it, the pro forma history.

And, so that kind of activity is going on and as this space is growing. We've been doing a lot to try to support the space because we are this major listing venue. We recently hired McKenzie to take a look at the way these products are trading, particularly on our exchange to make recommendations that we can improve our own practices on the exchange to better help investors and the managers in these products and also to come up with some industry-wide ideas on how the industry itself can make changes.

So we just continue to see a lot of growth in that area. BlackRock, obviously, has a very esteemed position with its iShares franchise. And so, we're fortunate to have them as a partner and hope to build out more business with them and then some of their peers as well.

I just mentioned AllianceBernstein is a slightly different product, some similar idea, but we now have a product that calculates the value of bonds in real-time as opposed to just giving an end of day mark. And by having a real-time estimate of where our bond should trade, we can put that on the desktop of a trader and in the mid-office and back-office for compliance people so that as a buyer and a seller are coming together to exchange a bond, there can be a sense that it was a fair price and that the compliance people can guarantee that, that was really the best execution that happened so that it meets the regulatory obligations that increasingly asset managers are taking quite seriously in putting the infrastructure in place.

So both of those areas are taking data that we provide and just using them in different types of calculations and new ways that we think will continue to grow the Interactive Data business. And so, it's really a privilege to have only owned the company for about 60 days, but yet to put two kind of major transactions together that I think will bode well for future transactions.

Q

Right. So I think you [indiscernible] (09:42), as opposed to growth in ETFs, the other big trend in the fixed income world is around the growth in electronic trading...

Jeffrey Craig Sprecher
Founder, Chairman & Chief Executive Officer

A

Right.

Q

...just given your franchise, what you have in terms of the data on the CDS patent execution, the legacy NYSE bond business, maybe just speak a bit about the appetite to grow the trading on the bond side and maybe the pros and cons of a buy versus build kind of opposed to that?

Jeffrey Craig Sprecher
Founder, Chairman & Chief Executive Officer

A

Christian, you mentioned – we have some interesting assets. We have a platform that was inside in New York Stock Exchange when we bought it, called 90 bonds, which uses a NYSE equity trading platform to list bonds on it. So you can imagine that, they trade just like stocks. So there's a bid offer, all-to-all market. It's very small, but we continue to nurture it and keep it alive because you know there is a sense at some of the more highly liquid part of the fixed income market might start to trade more like stocks.

Similarly on the other extreme. Credit X which has got technology around credit default swaps, which historically had been somewhat illiquid market, particularly prior to clearing. And we have a platform there, where we do bonds. Really, we do auctions for portfolios and bonds for people that – someone by appointment only want to get together and trade a group of largely illiquid securities at one moment in time in order to provide liquidity to them.

So we had both extremes on the barbell. Now, we have this new thing here that I've talked about, which is real-time pricing. That real-time pricing is pretty much distributed around the industry now. It's on a number of different trading platforms, third-party trading platforms. And the specific answer to your question is, I don't really know what we're going to do to – if we're going to pull all that together or not. So the thing that has been happening to my company is that we started the company to do electronic trading, and we basically built this network with proprietary users and content on it.

But over time now, we've been providing more and more services around risk management that are all part of the workflow, including services to help people trade on our competitors' platforms or to use competitive data and analytics. And so, rather than try to capture the entire risk management chain, we've started to unbundle ourselves and recognize that we should just provide value where we can provide value and try to maximize our user experience and get paid for that, and it doesn't mean we necessarily have to capture the entire value chain.

And that's a different mindset, but it's kind of where my industry is going right now. And we're just hopefully leading but, as a minimum, following the trend that I think is already in place.

Q

And maybe a little bit of time on the CDS business. Again, it's a place where you have the execution side, the clearing side, and then probably the hole or the missing part is the data side. So the same question, how do you think about either growing that as an opportunity and again buy versus build.

Jeffrey Craig Sprecher
Founder, Chairman & Chief Executive Officer

A

Right. So we have a large footprint in clearing credit default swaps. And as you may have seen, if you follow financial news, recently, there is much more of a push now by the buy side to embrace clearing of credit products and to try to re-invigorate the markets, particularly around single name credit default swaps.

To think about all the debt that – in this low-interest rate environment that we've had now for years, all the debt that's out there, and particularly in the energy space now, not to pick on anybody particularly, but in the energy space, you see people suddenly have a heightened concern about how will the high yield data in that space perform? And you've got people who wanted to risk manage around that space now with credit default swaps or whatever tools are available. So, partly to drive that's going on is now the recognition that with all the debt that exists in the world, there are pockets where people really do need to try to manage their portfolio or manage their risk and want the tools to do that.

We've been a beneficiary of that, the amount of clearing that the buy side is doing is growing. So while they're talking about this publicly to the press, they actually – their actions are following what they're saying. We've been wanting for years to try to develop a credit default swap futures contract, and we have a fledgling one. We've tried a couple of different types of ways of doing that.

I think long term that, that's – I think that's a meritorious product that long term is going to happen. But right now, what the buy side is saying is, look, we don't need to reinvent the wheel, just give me the markets that I'm accustomed to, but make them safer for me, take away my counter-party risk and help me to increase the velocity of those markets without having to completely revolutionize them. And so, we're trying to accommodate that as best we can. I think longer term though that some of the regulatory pressures and the mandates that are coming in for forced use of clearing, we'll start to create new products that I hope that we're at the center of, given the domain knowledge and the relationships we have.

Q

So, I guess, it's a bit of regulation. Let's flip to that one topic. So, I guess, MiFID II, you've been pretty vocal in terms of unbunging pieces and ultimately, impact of MiFID II should be over time kind of better revenues for you but unbundled. How do you think of that pulling out over time should it disrupt the business in the meantime, with the ultimate end being, obviously, more revenues, but a more disruptive time in the near-term?

Jeffrey Craig Sprecher
Founder, Chairman & Chief Executive Officer

A

Yeah. And I think I pick on MiFID II not because I think it will necessarily be negative for my firm, I actually think it's positive for my firm. But I just think it's negative for the end users. I think it's not – it's trying to help end users and, I think, in an odd way. It actually has the opposite impact. So on behalf of customers, I don't think customers really want fragmented markets. They do want competition, nobody wants to not have some choice. But forced fragmentation as a way of accomplishing that, I think, has some knock-on impacts, but it won't take into account when that door was passed.

But I think there are well-intentioned people now in government that are trying to figure out how to improve MiFID II and how to make it work for markets. And I think end users are having a bigger voice in that, which is why it's been delayed. And I think that delay is underneath that. There are some positive directions going on. Hopefully, we'll have to recast and reshape that bill in a better way.

But that being said, the trend is, even without MiFID II, there is already this trend that's going on of vulcanization of trading. When we talk to our agent customers, they honestly really don't understand Dodd-Frank and what the reporting obligations are and what the record-keeping obligations are and all the nuances in detail that go on in the U.S.

And it's not that they couldn't get educated, but the further away you are from a regulatory jurisdiction, the less you are – have been involved in the conversation and the more concerned and scary it looks from afar. And so, that drove our decision that we should build a trading and clearing platform in Asia, that we should list some of our products. So we should – in another words, we should fragment ourselves because the local people really do understand their local jurisdiction much, much better.

And so, this regulatory reform, even though regulators are trying to harmonize as they best can regulation around the world, it's just so – there's so much detail in it that we find that people really prefer to trade at least in jurisdictions that they understand. And that has nothing to do with MiFID II or anything else. I think it's already baked into the system. So we see more competitors. We have large global competitors, and they're listing all of our products, and we're listing all of their products. And what you see us all doing is these large exchange groups are taking our customers that are telling us that they don't like something or do like something and trying to meet their needs.

But it's largely jurisdictional, the division of markets that we used to kind of take for granted. We were homogeneous and traded 24 hours a day around the world. And we're doing well in that. I mean, we have our views and we have our footprint on where we have some secret sauce and special relationships and so we try to exploit those. And we have competitors that have their own secret sauce and special relationships that are doing well. And overall, the market volumes are growing as a result because when you fragment markets, then there are people that arbitrage them and try to put them back together, and they're willing to trade on a national or global scale and so overall, volumes go up, which is good for people like us that have revenue models that are tied to volumes.

But it does make it harder for the end user, and we have a hand in that. I'm not – we, ICE, on our own see that trend and are playing into it. So even though I complain about regulators, I'm not throwing the stone too far because I really do think end users feel like regional trading will be easier and better for them.

Q

I guess, we have a topic on regulations around clearing house capital requirements because every other day, we hear a regulator speaking about the growing systemic importance of the clearing houses. I guess, how do you, as an industry, try and relate ECS from both counterparties and regulators?

Jeffrey Craig Sprecher
Founder, Chairman & Chief Executive Officer

A

Well, it's an active conversation that's going to go on for a while because I think one thing that globally has been learned after the financial crisis is that if there is a default of some kind, a major default in a system that taxpayers do not want to be on the hook to pay for that default. And so, a lot of the conversation that's going on is really to say, other than the taxpayer, who is going to pay for this default?

And, large institutional buy side managers say, well, I shouldn't have to do it. Banks who provide clearing services, they're saying, I may not have the capital to do it. Clearing houses say, we don't want to change the risk portfolio so that the people that bring us risk aren't actually providing and having to pay for the risk because that will create a moral hazard. So there's a lot of reasons why a certain institution shouldn't pay for it. But the reality is, we've got to come up with solutions on who really is going to pay for it and how will default haircuts be shared across the market.

There is a lot of talk about clearing houses putting more skin in the game. But as I mentioned to you, you don't want – and there's a recognition in the industry as you don't want people to be able to just give risk to a clearing house without being charged for it because that would really change the self-policing nature of risk management. And so, clearly end users are going to be charged for the risk that they're taking on. And that capital is not going to be provided by the clearing house or by third parties.

And we're just kind of evolving that model, as an industry, so that the balance sheets are appropriately sized and that the pricing is appropriate for the amount of capital that is being provided. And long story short, I think it's going to get more expensive for end users because ultimately, regulators and politicians want the people that have the risk to pay for it or not take it on to begin with.

So we're pretty comfortable. I sort of started the skin in the game. When I created a new clearing house, we just felt that we should put money at the top of the risk waterfall as a show of faith that while we were new and young as a company that we had confidence in the thing that we were building and launching. That's caught on a little bit. But at this point, almost all major clearing houses have money at the top of their waterfall model and I think it's, honestly, pretty appropriately sized given the tradeoffs that exist in the market. I don't expect there to be wholesale changes to capital provided by the clearing house. I think it's really going to be operational changes inside the waterfall and how risk [indiscernible] (23:58) among the market.

Q

But do you think there should be some sort of – at some point you need to tap on how big clearing houses get?

Jeffrey Craig Sprecher
Founder, Chairman & Chief Executive Officer

A

I think it's fair to say that the market doesn't want one because it would have too much risk and too much power. But it doesn't want [ph] 50 (24:28) because it would take a lot of capital to support bifurcated markets around the world. You would lose the capital efficiency. So there are some number and I actually think the market is somewhat sorting that out. I hope regulators don't try to actually pick that number.

And I've said publicly before. I think the incumbent providers of clearing, the major exchange groups are likely going to be the big survivors in the perpetuity because we have long history of doing it. We've built the infrastructure. We have the regulatory compliance footprints that are being mandated. And it'd be very hard for an entrepreneur, including even my company, which is very entrepreneurial, to build a brand new one in this environment.

There just isn't the willingness on behalf of market participants and the regulators to take on a brand new one that hasn't had some level of market test to it. And so, I think where we and some of our major competitors are very well-positioned and I think – it's hard for me to imagine other than maybe some of them actually consolidating together over time because to give additional capital offsets. It's easier for me to see that than it is to say there's going to be more of them and have them more distributed.

Q

So I think I see [ph] Larry (26:00) waving his hand furiously at me. So do you want to ask a question?

Q

Yes, yes. I've seen some press reports suggesting that [Question Inaudible] (26:09-26:44)

Jeffrey Craig Sprecher
Founder, Chairman & Chief Executive Officer

A

Sure. I'm going to repeat your question for the audience that's listening. It's really questions about what's going on with all the Basel and capital rules and the banks and the articles that have been written recently.

I mean, there are so many different capital rules that are being put on banks that there are some, I think unintended outcomes, in certain cases may make clearing less desirable to certain banks than – even though public policy is that we should get positions in the clearing houses. There's been a lot of comment letters written, a lot of conversations with regulators and politicians that are overseeing these areas to try to make sure that the capital rules comport to the public policy goals around clearing.

That being said, the way I think of it on a macro level is that there are a lot of banks that provide a lot of clearing services to the buy side because the bank was also providing other services to the buy side. It was trading and providing flow of trading products that the banks were making money on. It may be have been doing lending, it may be have been doing other corporate services. And so, the back office clearing piece was somewhat given away as an accommodation to keep major customers in the fold.

Now that banks are having a look at where they put their balance sheets, clearing is very expensive use of balance sheet that a bank has to be compensated for, which means to me the cost of clearing has to go up in order to recognize that constraint on them.

It also means that there are a lot of conversations going on about whether or not the whole industry should rely on bank balance sheets as the first line of defense around clearing, or are there other access models to clearing that the buy side could come into clearing directly or be sponsored as an agent through a bank without having to hit those capital rules that the banks are accustomed to.

And we've done some things in Europe around that that really were a part of what regulatory reform in Europe was trending towards. I think we're having conversations in the U.S. about whether some of those techniques should be adopted. But long story short, a large institutional buy side firm has a hard time just becoming a member of a clearing house and neutralizing their customers' money with other money, so that in a default of a third-party that their own customers would be effected. But there have to be some other ways of introducing members and that's the real solution if the industry can't figure out a way for banks to have appropriate earnings on balance sheet and there may be both.

Q

[Question Inaudible] (29:54)?

Jeffrey Craig Sprecher
Founder, Chairman & Chief Executive Officer

A

Yes. So I mean, that there is a model that we've been working on with others, called sponsored access, where it'd be a hybrid of those, where the bank might provide the top of the waterfall, but further down the waterfall the institutional investor would take on some of that liability. It would result in potentially higher variation margin going in or maybe initial margin depending on how we work the haircuts by the buy-side. But in exchange for that, you would have – the buy-side firm would avoid the mutualization and the bank would still have a major customer and a major conduit to provide services around there.

So there is probably a hybrid that I think will ultimately land in the market, but until then we're working with regulators to make sure that public policy and capital requirements are heading in the same direction. And I would just tell you, as a minimum people are listening, I don't know that they're going to take action in that area, but there definitely is an audience of politicians and regulators that want to make sure that they've aligned public policy and actual regulatory reform.

Q

So, I'll ask one more question and then I'll open it to the broader audience. From a profitability perspective, [ph] everybody's trying to go on (31:29) one of their efficient firms, I think post NYX, you committed to [indiscernible] (31:32) 60% operating margins, and post IDC and TradePort, can we see margins ultimately track back up there, may be difficult in the timeline, but anything you can – there would be great also?

Jeffrey Craig Sprecher
Founder, Chairman & Chief Executive Officer

A

Yeah, I mean, I think the honest answer is that, I don't think, I'm a particularly good manager. So I don't think I'm particularly good at overseeing a large employee population. And so it's incumbent on me and my company to streamline the organization, flatten it and push decision-making down as close to the customer as we can. So that it doesn't involve me. Because, it's just not my strong suit and I know, I think part of the success for the company is that there is a lot of us that work together, and know what we can't do and not what we can do.

And so I tell you that just because, we will flatten any organization that we acquire, we will put, what we call our culture in it which is a culture of pushing decision-making closer to the customers and rewarding people that are willing to take calculated risks on behalf of the company and see them through and admit their mistakes and correct them. And all of that ultimately leads to a pretty efficient company that if you do it right have high operating margins. We've been fortunate to find the right businesses that are conducive to that culture.

Q

Any questions in the audience? Yep. [ph] Larry (33:14) again.

Q

[Question Inaudible] (33:16)

Jeffrey Craig Sprecher
Founder, Chairman & Chief Executive Officer

A

So question is -?

Q

[Question Inaudible] (33:33)

Jeffrey Craig Sprecher
Founder, Chairman & Chief Executive Officer

A

Yeah the question is about M&A opportunities particularly around the data space since that's been a trend in our company. You know one of the things that I'm seeing that's been interesting to me is that here eight years or so after the financial collapse, for the first time I'm really starting to see certain services that the banks use to provide to their customers leaving the bank ecosystem and making their way out into the third parties or providing those services.

It's just interesting that it's taken such a long time because I think there was a prediction that a lot of what was in the banking industry would make its way into the private sector, other parts of the private sector more rapidly. But I say that in the area like, I think people took for granted that you could call your local bank and that they would give you a price on a bond or help you mark your books to market or give you help on compliance or analytical tools and all of that within accommodation to their customers around their trading and clearing activities.

As banks have had their – revisit their footprint, many banks now no longer have the scale that they used to have, really can't provide those services, don't really have a reason to be providing some of those services. And you've seen those services get picked up by third parties like ICE and that seems to be accelerating right now. You lay over top of that a regulatory footprint where there is just a much more need for independent verification by boards of directors, by compliance people and by auditors and that really want a lot of independent verification validation over risk.

And so it's a long-winded way of saying yeah – seeing more and more or being approached by more and more interesting companies that are doing things that and even being approached by banks who have businesses that they no longer want to participate in, but that are looking to make their way into other financial services providers. The exchanges are becoming financial services companies, global financial services companies, global risk management companies. And we're used to producing selling data and analytical tools in our clearing houses and this is sort of a natural extension, the growth that you're talking about is the natural extension of what we already do, but seems to be in high demand right now in a lot of opportunities.

And in my case – in my company's case, growing really over the last couple of years in the highest organic growth, part of our business has been in these data and analytical services businesses.

Q

Any other questions? Just one last one from me. It's my take away from all this is, you're in a lot of businesses, lot of given big debates around market structure, regulation, et cetera, must be very time consuming, how do you go about allocating your time to do different businesses, do you think that time, the allocation of time versus the profit generation per unit, even lines up?

Jeffrey Craig Sprecher
Founder, Chairman & Chief Executive Officer

A

My job is to make sure I have people that can run and manage those businesses, so that my own self-preservation is that, I don't get a call in the middle of the night, you know that something's gone horribly wrong. And so, I think the best thing I can do as a manager is push as much decision making down as I can to qualify people. And I've been fortunate that – that we have stitched together our management team our – my management team and I have worked together a long time. And we know each other really well, and I've brought new members into the team, that sort of fit our culture. And it is the unique culture in the way we work together.

So, my colleagues – we sort of know what strengths and weaknesses we all have and then when to – my colleagues know when to ask me for help or advice, and I know when to ask them for help or an advice. And so you know, I'm definitely a mile wide, an inch deep, but I would tell you that, that there are a lot of really good people that oversee these businesses.

We recently promoted three people who I've worked with a long time, who I have a lot of respect for. And – given them bigger parts of the business, expanded my management committee which really operates the business collectively. And then – and so we feel really good about it. I had a call just before I got on here about some issues, and I as I hung up I mentioned to my colleague, Kelly, that you know how impressed I was to – the way the team is operating right now. So knock on wood, we're entering 2016 with a head of steam – a positive head of steam behind us. And really a lot of energetic people that are working on it.

Q

Great. I think with that we'll wrap it up. Thank you very much, Jeff.

Jeffrey Craig Sprecher
Founder, Chairman & Chief Executive Officer

A

Thank you very much, you guys.