

ICE Midland WTI American Gulf Coast (HOU) Futures and the inclusion of Midland in the Brent Complex

Key points

Mike Wittner, ICE's Global Head of Oil Market Research, recently gave a presentation at a conference hosted by the Crude Oil Quality Association. These key points summarize, and are adapted from that presentation and are available on ICE's website: [ICE Midland WTI American Gulf Coast Futures](#)

What is the role of ICE Midland WTI American Gulf Coast (HOU) Futures?

- HOU is a physically deliverable futures contract for Midland-origin/Midland-quality crude, priced in the Houston area. The futures prices converge with the physical prices.
- Since shale crude production began to increase in 2011, and since the US crude export ban was lifted at the end of 2015, the marginal barrel that sets the crude price for the US has transitioned to the US Gulf Coast (USGC), and away from Cushing, Oklahoma in the midcontinent region.
- On the USGC, Houston has emerged as the key pricing center, because it has both strong domestic demand from US refineries and strong global demand from refiners in Europe and the US.

Houston has evolved beyond MEH (Magellan), and ICE's HOU contract has evolved with the physical market.

- Midland crude is produced in the Permian Basin. Most Midland crude moves from the Permian Basin directly to the USGC. Very little Midland crude now flows to Cushing.
- The Houston physical market has evolved beyond the MEH facility.
 - MEH has 715 kb/d of direct inbound Midland-origin/Midland-quality connectivity (from the Bridgetex and Longhorn pipelines) and 9 Mb of crude storage capacity.
 - MEH plus ECHO (Enterprise) combined have 4+ Mb/d of direct inbound Midland-origin/Midland-quality connectivity and 60+ Mb of crude storage capacity (out of a total 150 Mb in the Houston area).
 - In January 2022, ICE restructured the HOU contract and teamed up with Magellan and Enterprise, in order to increase the crude infrastructure that underpins the contract.
 - HOU prices at, and is physically deliverable to, both the MEH and ECHO locations.
 - The Argus assessment of Houston crude prices only takes into account trades done at MEH. It is not a full representation of the Houston market. HOU is a more complete representation of the Houston market.

Midland WTI is the key US crude for both production and exports.

- US production growth continues to be driven by the Permian Basin, which has current output of around 5.7 Mb/d.
- Most output growth goes to exports, because most US refiners cannot process any more light sweet crude.
- Out of a total 3.6 Mb/d of US crude exports in 2022, roughly two-thirds was Midland WTI.

USGC crude pricing and risk management can be simpler, more efficient, and more effective.

- Currently, three trades are often used/needed to hedge risk for exports to Europe and Asia.
- In the example of exports to Europe, the three trades (or the equivalent) are:
 - A. ICE HOU vs. NYMEX WTI Cushing
 - B. NYMEX WTI Cushing vs. ICE Brent
 - C. ICE HOU vs. ICE Brent
- Currently, the trader does A and B
- The NYMEX WTI Cushing legs cancel, and the trader is left with C, which hedges the traders' exposure.
- A better way is to simply do trade C, which is ICE HOU vs. ICE Brent.
 - This is more efficient and simpler: it is a direct hedge, it is more liquid, and more visible/transparent.
- The simpler approach is also better value. Cost savings include elimination of multiple trades and lower transaction costs (margin offsets). Other savings include subscriptions to data and prices and broker commissions
- This makes more sense because it eliminates NYMEX WTI Cushing from the equation.

Crude pricing and risk management that involves NYMEX WTI Cushing introduces unnecessary risks.

- Fundamental risks include logistical /storage constraints at Cushing; inventory swings; Canadian pipeline leaks; refinery outages; and unreliable crude quality.
- Non-fundamental risks include managed money/non-commercial activity and ETF fund roll periods.
- For Midland-origin/Midland-quality crude, pricing that involves NYMEX WTI Cushing means pricing at a different location and for a different type of crude.

HOU crude quality meets a tight and robust specification.

- HOU is a globally applicable specification, with lower sulphur content and lower nickel and vanadium content than the NYMEX WTI Cushing specification
- HOU is for Midland-origin/Midland quality crude. In contrast, the NYMEX WTI Cushing specification can be met by blending in crude, such as Canadian crude
- The HOU specification addresses the “dumbbell crude” issue.

HOU trading activity has seen healthy growth since January 2022. The activity growth occurred in two steps.

- The first increase took place after the January 2022 contract restructuring to include both Magellan and Enterprise.
- The second increase happened after the June 2022 announcement/decision by Platts to include Midland WTI in Brent assessments.
- The HOU specification addresses the “dumbbell crude” issue.

Physical Midland WTI will be included in Brent pricing.

- Starting with June 2023 cargo deliveries, WTI Midland crude will be added to the current Brent “basket” of BFOET (Brent, Forties, Oseberg, Ekofisk, and Troll). It will be reflected in Dated Brent and the “cash” (i.e., physical forward) Brent price assessments.
- June 2023 cargo deliveries mean that Midland WTI will be included in Dated Brent assessments starting in the calendar month of May.
- The inclusion of Midland WTI in the “cash” Brent assessment already started, on February 1 2023. It is so far working smoothly, for both trading and pricing.
- Based on the HOU spec and Platts Midland WTI spec, the same physical Midland WTI crude barrels deliverable against HOU will be deliverable into the Dated Brent and “cash” physical markets.
- HOU will be the best instrument to hedge the trans-Atlantic arbitrage, from both a location and quality perspective.
- Claims that Brent will become “part of WTI” because of the Midland WTI volumes exported to Europe and able to be nominated for delivery into the physical Brent complex are misleading and inaccurate. Terminology matters because not all “WTI” is the same.
- As discussed above, Midland WTI is not NYMEX WTI Cushing. It is a significantly different crude grade (different quality and different origin) and is priced at a significantly different location. As a USGC crude, Midland WTI is part of the global waterborne markets, and is not a US midcontinent crude.
- The Brent complex has been evolving for decades. As with the addition of other crude streams to Brent in the past, Midland WTI is expected to be a healthy evolution for the Brent complex.

ICE Brent has been more resilient than NYMEX WTI and has outperformed it from a trading activity perspective in 2022 and so far in 2023. Unlike NYMEX WTI Cushing, ICE Brent open interest has returned to levels seen before the Russia vs. Ukraine war began in February 2022.

- ICE Brent is the global crude marker. Around 80% of traded crude prices off Brent, either directly or indirectly.
- ICE Brent reflects global macroeconomic and oil market fundamentals, as well as global geopolitics. It is a waterborne crude with flexible logistics and storage.
- In contrast, NYMEX WTI Cushing is a US crude marker. It reflects US domestic macroeconomic and oil market fundamentals. It has logistics and storage constraints at Cushing.

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