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February 10, 2014

Ms. Melissa Jurgens
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

RE: RIN Number 3038–AD99: Position Limits for Derivatives

Dear Ms. Jurgens:

The American Cotton Shippers Association ("ACSA") submits the following comments on the proposed rule "Position Limits for Derivatives." ACSA is comprised of Merchants, Primary Buyers, and Mill Service Agents with members located throughout the cotton belt from coast to coast. ACSA's member firms handle over 80% of the U.S. cotton sold in domestic and foreign markets. The significant market involvement of ACSA members requires that the Association take an active part in promoting the increased use of cotton in the U.S. and throughout the world; establishing with other cotton trade organizations national and international standards for trade; collaborating with producer organizations throughout the cotton belt in formulating farm programs; and cooperating with government agencies in the administration of such programs.

Derivatives have always been extremely important to our members, who are end-users utilizing such tools for legitimate commercial risk management purposes. Our members have been trading regulated markets for many years and we are fully supportive of strong trading rules, as a means of preserving market integrity and fair play. The debate about appropriate position limits in the various derivatives markets began with the run up in oil prices in 2007 and has been a controversial topic since. The financial crisis that ensued only intensified the debate. The primary claim by those who want strict limits has been that financial market participants, such as banks and hedge funds, have moved prices ultimately paid by consumers for end commodities through their large trading volume. This led to Congress instructing the Commodity Futures Trading Commission ("CFTC" or "Commission") to impose position limits where appropriate on a wider scope of contracts than previously legislated through the enactment of the Dodd-Frank Act in 2010 ("Dodd-Frank").

The CFTC proposal has much broader implications for the marketplace than we believe were envisioned by the Congress. Our belief at the time of passage was that while we could expect some behavioral changes in the operation of the derivative markets given the position limits provision, we would not see a direct impact to the trading of our members. Commercial end-users did not cause the financial crisis and therefore do not believe our hedging activity in these markets should be restricted. Some of our members are also members of other trade

associations, some of which submitted comments on the proposal. We specifically cite the comprehensive letter submitted by the Commodity Markets Council ("CMC") and write in support of their comment letter.

For the purposes of this letter, we would like to focus on issues of significant importance to our membership and urge the Commission to modify certain provisions that would not change what we believe was the intent of Congress, and, if made, would remove key restrictions to hedging in the marketplace contained in the Proposed Rule. ASCA is primarily concerned with issues surrounding the definition of bona fide hedging and the commercial allowance of anticipatory hedging.

ACSA is concerned that the position limit rule as proposed would adversely affect the ways in which our members effectively manage legitimate commercial risk in the cotton industry through the use of derivatives. We believe the Proposed Rule narrows the concept of bona fide hedging and forgoes many of the well-understood concepts contained in CFTC regulation 1.3(z) definition of "bona fide hedging transaction." Of notable concern is the Proposed Rule's omission of anticipatory merchandizing hedges as provided for in the statutory definition within Dodd-Frank. In order to maintain the practical utility of the derivatives markets for the cotton industry, ACSA urges the Commission to preserve key components of CFTC regulation 1.3(z) and amend regulation 1.3(z) and regulation 150.4 to include merchandising hedges in the definition of "bona fide hedging transaction."

Anticipatory Hedging Should Not be Restricted, Particularly for Merchandising Activity

Dodd-Frank amended the Commodity Exchange Act ("CEA") to specifically include three definitional statements in reference to a *bona fide* hedge. It states that a *bona fide* hedge:

> (i) represents a substitute for transactions made or to be made or positions taken or to be taken at a later time in a physical marketing channel;
> (ii) is economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise; and
> (iii) arises from the potential change in the value of—
> - (I) assets that a person owns, produces, manufactures, processes, or ***merchandises*** or ***anticipates*** owning, producing, manufacturing, processing, or ***merchandising***;
> - (II) liabilities that a person owns or ***anticipates*** incurring; or
> - (III) services that a person provides, purchases, or *anticipates* providing or purchasing.[1] (emphasis added)

We believe that the Commission should follow the intent of Congress in further defining a bona fide hedging position. The CEA specifically lists derivatives transactions in connection with anticipatory merchandising activity as being bona fide hedges and therefore exempt from position limits. ACSA also notes that the Commission recognizes anticipatory merchandizing hedges in the context of other rules such as the Volcker Rule for banks and nonbank financial companies. In addition, we request the Commission provide additional information as to how anticipatory hedging will work in practice. ACSA respectively requests the Commission to also

[1] CEA Section 4a(c)(2)

follow Congressional intent with respect to the statutorily permitted risk management activities in which ACSA members and other end-users are engaged.

Economically Appropriate Risk Management Activities

The Proposed Rule requires a *bona fide* hedge to be "economically appropriate to the reduction of risk in the conduct and management of a commercial enterprise,"[2] not unlike current CFTC Regulation 1.3(z). ACSA recommends the Commission clarify that such requirement (the "economically appropriate requirement") stand for the proposition that a derivative transaction for which bona fide hedging treatment is sought must be (i) one that a commercial firm deems to be risk reducing, however such risk reduction is defined in the business judgment of the firm, and (ii) the risk reduced must arise in the commercial activities of the firm (the "suggested interpretation").

The Commission did not define what constitutes "commercial enterprise." ACSA believes a definition is not necessary should the Commission adopt the suggested interpretation of the economically appropriate requirement. The central concept is that the derivatives transaction occurs in connection with a firm's commercial activity. In the alternative, ACSA urges the Commission clarify that each market participant be allowed to define what constitute a "commercial enterprise" so as to match the way in which manages risk. Firms might manage risk at an entity level[3] or a smaller segment of its business (or both). The Commission should avoid a concept of "commercial enterprise" that is inconsistent with how commercial firms manage risk.

ACSA is also concerned that the Commission, through the economically appropriate test, has imposed a new test for identifying a bona fide hedge. The Proposed Rule preamble states:

> "In order for a position to be economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise, the enterprise generally should take into account all inventory or products that the enterprise owns or controls, or has contracted for purchase or sale at a fixed price."[4]

This language suggests that a bona fide hedge only exists when the net price risk in some defined set is reduced. We believe this test is not representative as our member firms look at risk in many ways not limited to price risk as mentioned above. The most appropriate way to deem a derivatives transaction as "economically appropriate" is whether a commercial firm has a risk abated by the transaction, and such risk arose in its commercial business. Linking the availability of bona fide hedging treatment to a net reduction in a portfolio of risks is not how commercial firms address risk. Moreover, individual firms identify which risks they want to accept. A transaction that may increase the risks inherent in one side of the business might serve legitimate business purposes. Thus, to impose a "net price risk" formula for purposes of bona

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[2] Proposed Rule at 75823.

[3] The economically appropriate requirements becomes even more problematic under the aggregation rules, which could force the consideration of positions of business units that are operationally separate with no coordinated control or information sharing.

[4] Proposed Rule at 75709.

fide hedging effectively replaces a commercial firm's business judgment with regulatory prescription.

Gross and Net Hedging

The Commission uses concepts of gross hedging and net hedging in its discussion of the economically appropriate requirement. We believe that these terms should be separately defined. ACSA understands gross hedging to be the practice of separately hedging each of two or more related positions. Net hedging happens when that firm nets its purchase and sale contracts to a net long position of two contracts, and then offsets that risk by entering into two short derivatives transactions. ACSA asks the CFTC to (i) affirm these definitions of "gross hedging" and "net hedging" and (ii) affirm that each of these methods entail derivatives that would be eligible for bona fide hedging treatment.

Sophisticated commercial hedging is as important today as ever, given volatility in the marketplace. Successful hedging ultimately benefits the general public by reducing the volatility of consumers of commodities such as cotton. We appreciate the Commission's consideration of our views on this critical issue.

Sincerely,

William E. May
President & CEO