Atlanta Calgary Chicago Houston London New York Singapore

February 10, 2013

Via Electronic Submission

Ms. Melissa Jurgens
Secretary
Commodity Futures Trading Commission
1155 21st Street, N.W.
Washington, D.C. 20581

Re: ***Position Limits for Derivatives***

Dear Ms. Jurgens:

IntercontinentalExchange, Inc. ("ICE") appreciates the opportunity to comment on the Commodity Futures Trading Commission's ("CFTC" or "Commission") proposed position limits for derivatives (the "Proposal" or "Proposed Rules"). As background, ICE operates regulated derivatives exchanges and clearing houses in the United States, Europe, Canada and Singapore. As the operator of U.S. and international exchanges, trade repositories and a swap execution facility that list both OTC and futures markets, ICE has a practical perspective of the implications of the proposed position limit regime.

Executive Summary

ICE supports aggregate positions limits if properly applied. In promulgating final rules, the Commission should consider:

- Waiting to impose any new position limit regime until the Commission can adequately study whether the existing position limit structure is working;
- Allowing higher position limits for financially settled contracts;
- Adopting position limits for the nearby months to expiration instead of an all months position limit;
- Removing Trade Options from the definition of physical-delivery Referenced Contract and exempt Trade Options from the Proposed Rules;
- Permitting market participants to make commercially reasonable determinations of which contracts are substantially related for the cross-commodity hedge exemption;
- Interpreting the orderly trading requirement consistently with the disruptive trading practices rule; and
- Keeping arbitrage and spread exemptions.

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Policies Underpinning the Proposed Limits

The proposed limits differ considerably from the final rules issued by the Commission in 2011 and as detailed below will likely impact commercial participation in the Referenced Contracts. At the same time, the energy and agricultural markets have changed greatly since 2011 especially with the transition of energy markets from swaps to futures. As of October 2012, all U.S. energy contracts have position limits. In addition, energy markets have significantly changed. Following high energy prices in 2007 and 2008 we have seen increased investment in energy production and transportation. For example, in 2012, for the first time since 1949, the U.S. was a net exporter of oil.[1] Given this fact, the Commission should carefully consider any changes to what is a well-functioning market. The Commission should especially consider the potential impact of this proposed rule on the price discovery process, particularly in energy markets. We strongly suggest that the Commission wait to see the impact of the existing position limit regime before implementing more changes. This new rule could have a lasting (and potentially irreversible) impact on the U.S. energy market.

Moreover, a well-designed position limit regime should strike the right balance among the prescribed statutory goals of diminishing excessive speculation and deterring market manipulation and ensuring sufficient market liquidity for bona fide hedgers and the price discovery function of the underlying market. In the Commodity Exchange Act, Congress has included a long-standing, express prohibition against unwarranted limits on bona fide hedging transactions or positions of commercial parties. Section 6a(c) of the CEA directs the Commission to adopt a definition of "bona fide hedging transactions or positions" that is "consistent with the purposes of this chapter," which include, "permit[ting] producers, purchasers, sellers, middlemen, and users of a commodity or a product derived... to hedge their legitimate anticipated business needs."[2]

Furthermore, by including the CEA requirement that the Commission must find position limits are "necessary" and "appropriate" before imposing them, Congress recognized that restrictive limits would impede market liquidity and price discovery. When the Commission exercises its regulatory oversight authority, it must be cognizant of the effect of the proposed federal limits on the ability of derivatives markets to perform their fundamental price discovery, risk transfer, and risk management functions, which depend on the existence of liquid, fair, and competitive markets. Therefore, any proposal that would tend to adversely affect the liquidity, fairness or competitiveness of the futures markets must be carefully scrutinized.

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[1] http://www.bloomberg.com/news/2012-02-29/u-s-was-net-oil-product-exporter-in-2011.html
[2] 7 U.S.C. § 6a(c)(1); see also Commodity Exchange Act, Pub. L. No. 74-675, 49 Stat. 1491 (1936) (the prohibition against limits on bona fide hedging transactions or positions has been a part of the CEA since its adoption in 1936).

In its proposed rules, the Commission has recommended significant changes to the position limit regime for derivatives. Protecting the integrity of the derivatives markets from excessive speculation is a laudable goal, but it is important to note that the Commission has neither demonstrated nor determined that excessive speculation exists in the derivatives markets. New section 4a(a)(3) of the CEA qualifies the CFTC's authority by directing it to set such position limits, "as appropriate. . . [and] to the maximum extent practicable, in its discretion: (i) to diminish, eliminate, or prevent excessive speculation." This requires factual support for position limits based on preventing excessive speculation or deterring market manipulation balanced against the impact on market liquidity and price discovery. The Commission has not provided or sighted such factual support or evidence that speculation causes changes in commodity prices. It is vitally important that the Commission take action that reasonably addresses these issues. Tying position limits to excessive speculation, especially without a finding of excessive speculation, could lead the Commission to play the role of price authority.

ICE believes that position limits should be set to prevent manipulation around contract expiry and delivery and to prevent delivery disruptions, and not with a goal to influence commodity price levels. In determining position limits, the Commission should consider the entire size of the relevant markets – both exchange-traded and OTC and both domestic and domestically linked. This is very important because the proposed rule may set position limits before the mandatory trading and clearing provisions of Dodd-Frank are fully in effect. Thus, the proposed rules will come at a time of significant change in derivatives markets as market participants will be bringing business traditionally conducted bilaterally onto exchanges. By implementing an onerous position limit regime and limiting all financial and physically delivered contracts to deliverable supply, the Commission may inadvertently restrict the ability of market participants to put positions onto exchanges and clearing houses at the same time that Congress is requiring more, or all, positions be cleared and exchange traded.

Further, the Commission should set position limits not based upon current activity alone, but to permit growing participation in the derivatives markets. The 2011 position limits rule and the proposed rule are based on extremely limited market data. The Proposed Rule only considers open interest during calendar years 2011 to 2012 for futures contracts, options on futures contracts, and significant price discovery contracts that are traded on exempt commercial markets. It ignores the volume of OTC transactions in Referenced Contracts for which the Commission has collected detailed information.[3] The Commission also declined to rely on open interest data from the Part 20 swaps large-trader reporting data and swap data reported to swap data repositories ("SDRs") in accordance with Parts 43, 45, and 46 of the Commission's rules. Failing to accurately assess market size and thus, liquidity needs, in setting position limits, accountability levels and appropriate exemptions will likely result in artificially low limits and create barriers to a well-functioning, centrally cleared, regulated and competitive derivatives market in the United States.

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[3] *See* Proposed Rule at 75730.

Considering these factors, ICE respectfully offers the following comments regarding the framework outlined in the Commission's proposed rules.

Aggregate Spot Month Limits

The Commission proposes to adopt an expanded version of the designated contract market position limit regime and set position limits at 25% of deliverable capacity for physically delivered contacts. This limit would be applied to exchanges on an aggregate basis, but financial and physically settled contracts will have separate limits. In general, ICE supports CFTC properly setting and administering single and all month spot position limits that aggregate positions of closely expiring, economically equivalent contracts across multiple trading venues. Economically equivalent contracts that vary only by where they are listed for trading or in how they are settled have been repeatedly shown to trade as a single market up until the final days of trading. A June 2007 report published by the U.S. Senate Permanent Subcommittee on Investigations entitled, "Excessive Speculation in the Natural Gas Market," focused on natural gas trading by the hedge fund, Amaranth Advisors, in both the NYMEX physical futures market and the ICE swaps market. The report is replete with analysis supporting the conclusion that these two markets, one physically settled and the other cash settled, were and are "functionally equivalent" and "provide economically identical hedging and risk management functions."[4] As a result, it is necessary to aggregate such positions to monitor market concentration and enforce market-wide limits. The CFTC is the appropriate body to do this since it is exchange-neutral and has access to all position data. Furthermore, Congress, in its financial reform efforts, has expanded CFTC access to OTC position data and authority over OTC markets – adding yet another data source for CFTC aggregation. ICE believes however that the aggregate spot month limits should be liberally set because they are "hard" limits for which positions in excess can be considered a felony and they represent the broadest possible aggregation of economically equivalent contract positions regardless of exchange, settlement type (physical or cash), or specific expiration date. Since position limits will aggregate across trading venues and will apply to OTC swap contracts, ICE recommends the Commission propose limits which do not reduce liquidity and hamper the price discovery function of the commodity markets. ICE further recommends the Commission continue to gather additional data regarding the OTC swaps

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[4] *"The data analyzed by the Subcommittee, together with trader interviews, show that NYMEX and ICE are functionally equivalent markets. Natural gas traders use both markets; employing coordinated trading strategies…The data show that prices on one exchange affect the prices on the other."* ("Excessive Speculation in the Natural Gas Market", U.S. Senate Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, Sen. Carl Levin, Chairman, June 25, 2007, p. 3.)

"The ICE natural gas swap and the NYMEX natural gas futures contract perform the same economic functions." (Ibid, p. 29).

"In sum, the structure of the ICE swaps and NYMEX futures contracts, the virtually identical prices of these two contracts, and the testimony of traders provide compelling evidence that the NYMEX natural gas futures contract and the corresponding ICE natural gas Henry Hub swap are economically indistinguishable financial instruments for risk-management purposes." (Ibid, p. 36).

markets so that the Commission can make a more informed decision regarding position limits in the future. Given that the CFTC has limited data on the OTC swaps market for the 28 referenced commodities, especially due to the high percentage of end-user to end-user OTC swap transactions coupled with an end-user effective reporting date of August 19, 2013, we believe that it would be premature for the Commission to impose restrictive spot-month limits. Until such time as the Commission has more robust data regarding the OTC swaps market, it is impossible for the Commission to set appropriate position limits on these contracts without severely impairing the liquidity and price discovery functions of the commodity markets.

ICE further recommends that the Commission establish spot position limits for cash-settled contracts at levels higher than the physically-delivered contracts because cash-settled contracts are less susceptible to manipulation.[5] While ICE agrees that deliverable supply is the appropriate basis for setting limits on physically settled-contracts, which involve the making and taking of delivery and impact a commodity's settlement price, we do not believe the same is true for cash-settled contracts. Imposing equal levels for each contract type presupposes that contracts are fungible, which they are not, and may result in unnecessarily constraining legitimate risk management activity in the spot month. Historically, a 25% spot month limit is necessary to prevent corners and squeezes in a physical contract. In agricultural contracts, this is appropriate as the markets are physical and no meaningful cash-settled contracts presently exist. However, in the energy markets there is robust participation and liquidity in financially settled energy contracts, which do not make claims on physical supply. In fact, today the vast majority of energy contracts are cash settled. These products serve an important function in the market, providing market participants with the ability to hedge exposure to the final contract settlement price without basis risk and allowing them to avoid the potential burdens of physical delivery that is attendant to a physically delivered contract. Moreover, cash-settled contracts in the spot month do not have the potential for unwarranted changes in price and market manipulation that physically-delivered contracts have because they do not require delivery of a physical commodity that is subject to limited supply. As such, the prices of cash-settled spot-month contracts can fluctuate and converge to the price of the physical commodity as settlement approaches. By contrast, it is possible that limitations on transportation and on available supply of an underlying physical commodity can lead to price distortions and opportunities for price manipulation in spot month contracts that must be satisfied by physical delivery. For these reasons, it is appropriate for the Commission to set limits higher for cash settled contracts in the spot month.

Finally, in its spot month position limit regime, the Commission has proposed a new definition of spot month. In particular, for average price contracts, the Commission proposes to expand the spot month to the entire period for calculation of the settlement price. Thus, for a monthly average price contract, the spot month would be the entire month rather than the current exchange practice of the final three days (or week) before final settlement. The Commission has

[5] *See* Former CFTC Rule pt. 38, app. B, core prin. 5, para. (b)(2) (2010). The Commission previously stated that the potential for distortion of prices is "negligible" for cash-settled contracts.

always encouraged the development of average price contracts given that these contracts do not have a discrete settlement period that can be susceptible to manipulation. Expanding the spot month position limits on these contracts would only serve to discourage creation and participation of average price contracts. The Commission should adopt current exchange practices and employ a spot month that covers the final three days or week before settlement.

Conditional Spot Month Limit for Financially Settled Contracts

Since February 2010, the CFTC has provided for a "Conditional Limit" for financially settled natural gas contracts during the last three days of contract trading. Under the Conditional Limit, a market participant may carry a position in the financially-settled natural gas contracts (ICE H or CMENN) that is up to 5 times that of the physically-settled natural gas contract's (CMENG) position limit if the participant agrees not to hold a position in the NG contract in the last three days. In the Commission's 2011 position limit rule, the Commission codified the Conditional Limit. As the Commission stated in the 2011 rulemaking: "[t]he proposed limit maximizes the objectives, enumerated in section 4a(a)(3) of the Act, of deterring manipulation and excessive speculation while ensuring market liquidity and efficient price discovery by establishing a higher limit for cash-settled contracts as long as such positions are decoupled from large physical commodity holdings and the positions in physical delivery contracts which set or affect the value of cash-settled positions." In the four years since the Conditional Limit provision went into effect, natural gas prices have been lower and less volatile than historical levels. ICE has received no complaints regarding natural gas markets during that timeframe nor are we aware of any complaints received by CME or the CFTC. Liquidity in the physically-settled CME NG contract has also increased.

The Commission has already recognized the need for and benefits of the Conditional Limit. The position limit rule now pending before the Commission reaffirms this policy and recognition that many market participants have a need to pay or receive the final settlement price of the Referenced Contract to perfect their hedges and that this is most effectively accomplished by holding cash-settled futures or bilateral swaps to expiration. Removing or reducing the Conditional Limit would disrupt present market practice. Furthermore, eliminating or decreasing the Conditional Limit for cash-settled contracts would be a significant departure from current rules, which have the support of the broader market. The proposed rule itself will already effectively halve the present Conditional Limit by converting it to an aggregate limit across designated contract markets ("DCM"), swap execution facilities ("SEF"), and the bilateral OTC market. Further constraining this limit would reduce even further the ability of hedgers to cost-effectively take swaps to final settlement as necessary to perfect their hedges.

Moreover, ICE urges the Commission to appropriately recognize the vastly different expiry behavior of physical versus cash-settled contracts and, in doing so, remove or, at least, further liberalize the last three day position limit methodology for cash-settled contracts. By ordering a last three day position limit methodology for the ICE Henry Hub natural gas contract

that was materially different from the CME natural gas futures contract, the Commission had already correctly concluded that physically delivered contracts and their cash-settled lookalikes behave very differently at expiration and therefore require different expiration position limits. Therefore, a higher limit for cash-settled contracts makes sense. In addition to the Conditional Limit, the Commission should explore a higher cash-settled limit that allows participation in the physically-settled market, similar to the 2011 position limit rule.

Finally, under Part 19 of the proposed rules, a market participant that relies on the Conditional Limit must file a Form 504 daily with the Commission. The daily statements relate to cash commodity positions and are broader than the category of cash-market positions eligible for *bona fide* hedge positions. As a result, reporting systems now need to identify a broader class of cash market activity for Form 504 compared to cash market activity to be reported on Form 204. This proposed daily reporting requirement imposes significant burdens and substantial costs on market participants and requires the development of additional systems to identify all cash-market positions as opposed to cash-market positions eligible for the *bona fide* hedge exemption. ICE recommends that participants relying on the Conditional Limit should be permitted to file monthly *bona fide* hedging reports, rather than a daily filing of all cash market positions consistent with current exchange practices.

Position Limits in Non-Spot Months

The Commission proposes non-spot month limits that apply to a person's "single month" and "all months combined" positions using a formula with an open interest calculation. The single month and all months combined limits will be based on 10 percent of open interest for the first 25,000 Referenced Contracts and 2.5 percent of open interest thereafter. Unlike the 2011 position limit rule, the Commission proposes hard numbers for the level of non-spot month position limits based on current estimates of open interest. For the initial non-spot month limits, the Commission proposes to use data from calendar years 2011 and 2012, and limited open interest data to futures contracts, options thereon, and swaps that are significant price discovery contracts. For setting subsequent limits for single months and all months combined, the proposed rule would identify the level of open interest in Referenced Contracts by including data that the CFTC obtains from market participants in connection with its new swap reporting rules.[6]

The Commission should consider whether all month position limits are necessary or appropriate in energy markets for the long-dated portions of the trading curve. While hard limits in the expiration month and months surrounding the expiration month are appropriate, blanketing such limits across all contract months may have unintended effects on the proper operation of markets, such as draining speculative liquidity from the longer dated portions of the trading curve where it is most needed. It is also important to consider that large speculative traders are often the only market participants willing to assume price risk in long dated portions of the

[6] *See* Re-Proposed Rule, 78 Fed. Reg. at 75734.

trading curve where commercials are attempting to layoff price risk. As such, one potential impact of an all month regime is that such parties could choose to exit the longer dated portion of the market, sapping valuable liquidity from commercial market users and their ability to hedge long dated risk. Hard position limits in the first 18 months of a contract and position accountability levels in the remainder of the contract would encourage speculative participants to assume risk in out months and give commercial participants the ability to hedge exposure farther in the future. The accountability level approach to monitoring exchange-specific positions provides the necessary flexibility to address the unique circumstances of each large position holder, but avoids the clearly anticompetitive effects of exchange-specific concentration limits.

The Commission should also note that setting aggregate hard position limits across contract months and trading venues adopts the current position limit regime for agricultural markets. This regime was designed for domestic agricultural markets, which are primarily seasonal markets, and one can understand why an all month position limit regime could be important in such a market given the potential impact of positions held in all months on less liquid, seasonal markets. By comparison, energy markets, such as crude oil, are not seasonal markets per se and present different time horizons for hedging price risk. For example, farmers may be primarily interested in hedging price risk for the following season's crops. In comparison, energy companies generally hedge price risk far into the future given the long lead times for energy exploration and extraction. Imposition of all month position limits for these markets could sap vital speculative liquidity from long dated portions of the pricing curve, making future price signals less accurate and potentially inhibiting commercial market participants from being able to hedge long-dated price risk. This is not simply a theoretical concern – if markets are inhibited from sending accurate future price signals that reflect rising demand, important energy infrastructure may not be built today that will be needed to meet tomorrow's energy needs.

A position accountability regime rather than a hard position limit regime for all months would serve the Commission's purpose concerning monitoring positions further out the curve. As noted above, the Commission could proscribe aggregate hard limits in the nearby months, where price discovery principally occurs and allow position accountability levels for contracts months further out the curve. Accountability level regulation, by design, is intended to serve as an early warning system that triggers heightened surveillance by the exchange and puts the trader on notice. Position accountability levels are set low for this very reason.[7]

Deliverable Supply Estimates

The Commission proposes to set spot month limits at 25% of deliverable supply of the underlying commodity. The CFTC proposes to base initial spot month limits on the levels currently in place at designated contract markets, but is considering alternative deliverable

[7] The current position accountability levels for ICE OTC's Henry Hub contract are approximately 1% of open interest, far lower than the proposed concentration limits.

supply estimates. ICE supports using alternative estimates for deliverable supply which update deliverable supply to reflect current market circumstances.[8] ICE believes that where deliverable supply is used to determine position limits, the Commission must ensure that it measures deliverable supply broadly enough to avoid unnecessarily and inappropriately limiting trading. Revised deliverable supply estimates are necessary to maintain liquidity and price discovery functions in the spot month, as position limits will aggregate across trading venues, and will apply to uncleared OTC swap contracts. As such, ICE urges the Commission to adopt revised deliverable supply estimates which reflect current market conditions.

Bona Fide Hedge Exemptions

The Commodity Exchange Act states that, "[n]o, rule, regulation, or order issued under subsection (a) of this section shall apply to transactions or positions which are shown to be *bona fide* hedging transactions or positions . . . Dodd-Frank directs the Commission to define a *bona fide* hedge exemption as off sets of cash market transactions." This new definition of a *bona fide* hedging transaction is far more limited than Commission regulation § 1.3(z)(1) and narrower than the definition proposed in the 2011 position limit rule. In addition, the Commission has narrowed the bona fide hedging exemption to a list of enumerated bona fide hedging transactions instead of all physical commodity price risk-reducing transactions entered into by commercial market participants. The current position limit proposal does not recognize non-enumerated hedges as bona fide and only allows market participants to receive position limit exemptions for non-enumerated hedge positions if the Commission grants an ad hoc request for an exemption. This restrictive definition and limited bona fide hedge exemption list will constrain the ability of firms to use the derivatives markets to hedge. Moreover, the Commission has eliminated the spread and arbitrage exemptions which will impede the price discovery process on derivatives exchanges. The proposed orderly trading requirement will also constrain market participants' ability to unwind and exit positions.

In general, the proposal extends the program for granting *bona fide* hedges that currently exists for the enumerated agricultural commodities to energy contracts. However, the proposed rules do not recognize that commercial market practices in these markets differ from those in the enumerated agricultural products and that, consequently, merely extending the current Commission program to these commodities will create a flawed system. Unless the Commission considers and modifies its proposed rules to account for the differing commercial practices, serious consequences may flow to commercial participants in those markets. In particular, we are concerned that the proposed rules could needlessly prevent such participants from fully managing their commercial risk through futures and options that are cleared through entities regulated by the Commission.

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[8] On August 15, 2012, in conjunction with ICE Futures US conversion from swaps to futures, ICE submitted a filing providing its revised estimates for deliverable supply. This submission provided evidence and justifications for higher deliverable supply estimates.

For instance, the Commission narrowed the bona fide hedging exemption to a list of enumerated bona fide hedging transactions. This is a departure from the 2011 position limit rule which did not categorically exclude non-enumerated hedging transactions from receiving bona fide hedging treatment. [9] The new proposal similarly does not recognize non-enumerated hedges as bona fide and would allow market participants to receive position limit exemptions for non-enumerated hedge positions only if the Commission grants an ad hoc request for an exemption. ICE recommends the Commission utilize the enumerated hedge exemptions as examples of a sub-set of the range of transactions that qualify as bona fide hedging transactions and to not categorically exclude non-enumerated hedging transactions from receiving bona fide hedging treatment. In addition, the proposed procedures for applying for and granting exemptions of non-enumerated hedge exemptions are complex, vague and will create uncertainty for market participants as to when and whether their hedging strategies will qualify as a bona fide hedge. Market participants can petition the CFTC, pursuant to CEA section 4a(a)(7), to issue a rule, regulation or order, to expand the list of enumerated positions to include the position described in the petition.[10] However, in contrast to the Commission's existing procedures for granting non-enumerated hedge exemptions, the exemption process in the Proposed Rule does not specify a timeframe within which the Commission must address a request. Currently, under CFTC Rule 1.47, the CFTC Staff have 30 days to respond to a new request for a non-enumerated hedge position or 10 days to respond to an amendment to an existing request. ICE recommends that the Commission continue to authorize non-enumerated hedging transactions through mechanisms like the ones in existing CFTC Rules 1.3(z)(3) and 1.47.

Moreover, the proposal eliminates the spread and arbitrage exemptions that are currently recognized by exchanges. In ICE's energy contracts, the spread and arbitrage exemptions are vitally important to the functioning of the markets because they allow participants to hedge risk assumed through the normal course of business. ICE uses the spread exemption to allow traders to spread positions between the Henry Hub natural gas contract and natural gas basis points. Hedging basis risk allows a trader to hedge the cost of delivering natural gas to any particular point in the country. Given that the Commission is not aggregating basis contracts as referenced energy contracts, a spread exemption for these transactions is vitally necessary to allow traders to hedge basis risk in natural gas.

The arbitrage exemption is also critical to the energy markets by allowing, as the Commission recognizes, the arbitrage of economically equivalent contracts to create one market. Arbitraging ensures that if one market does not reflect fundamentals, it will eventually be brought back into line with other markets, which greatly decreases the risk of a market being manipulated over the long term. In addition, the open access provisions of Dodd-Frank encourage the listing of economically equivalent swaps by SEFs. Without arbitraging, prices of

[9] *See* 17 CFR 1.3(z)(3).
[10] Proposed Rule at 75718. The Proposed Rule also provides that market participants can file a request for an interpretation from Commission Staff under CFTC Rule 140.99 regarding whether a hedging position falls within the existing list of enumerated hedging positions. *See id.* at 75717.

equivalent swaps on these SEFs could begin to diverge, and could ultimately create misleading settlement prices, which in turn could present greater risk to clearing houses.

In addition, the proposal amends the definition of bona fide hedging to require that a hedge position be established and liquidated in an orderly manner in accordance with sound commercial practices. The Commission also states that it intends to impose a standard of "ordinary care" on bona fide hedgers when entering, maintaining an exiting the market. The Commission believes that "negligent" trading should be a sufficient basis for the Commission to disallow a bona fide hedging exemption. The CFTC also explained that it intends to apply its policy regarding orderly markets for purposes of disruptive trading practice prohibits to its orderly trading requirement for purposes of position limits. The standard of care for the proposed orderly trading requirement goes beyond the conduct standard under the Disruptive Trading Practices Policy Statement.[11] The policy statement only imposes liability for intentional or reckless conduct under Section 4c(a)(5)(B) and states "that accidental, or even negligent, trading, practices or conduct will not be a sufficient basis for the Commission to claim a violation . . ."[12]. The Commission should interpret the orderly trading requirement consistently with the disruptive trading practices rule and not further constrain market participant's ability to exit positions and effectively manage their risks.

Cross-Commodity Hedge Exemptions

Under the Commission's and exchanges' existing rules governing *bona fide* hedging positions, market participants can rely upon a cross-commodity hedging position where the "fluctuations in value of the position for future delivery are substantially related to the fluctuations in value of the actual or anticipated cash positions."[13] Both the Commission and the exchanges have a long and effective track record of administering this requirement. The Commission's Proposed Rule permits cross-commodity hedging based on a qualitative standard similar to its existing speculative position limits rule. However, the Proposed Rule includes a rebuttable presumption that a hedge is not eligible as a cross-commodity hedge if it does not meet a quantitative factor. The Commission proposes to adopt a non-exclusive safe harbor on the meaning of substantially related contracts that includes two factors: (a) qualitative factor: reasonable commercial relationship between the target commodity and the commodity underlying the commodity derivative contract; and (b) quantitative factor: reasonable quantitative correlation in light of available liquid commodity derivative contracts. The Commission will presume an appropriate quantitative relationship when the correlation, between first differences or returns in daily spot price series for the target commodity and the price series for the commodity underlying the derivative contract is at least 0.80 for a time period of at least

[11] CFTC Interpretive Guidance and Policy Statement on Disruptive Practices (May 20, 2013)
[12] See 78 Fed. Reg. 31890, 31895 (May 28, 2013).
[13] *See* CFTC Rule 1.3(z)(2)(iv); *see also Glossary*, CME GROUP, http://www.cmegroup.com/education/glossary.html (last visited Jan. 28, 2014) (glossary definition of "cross hedging").

36 months. The Commission also asserts that fluctuations in the value of electricity contracts typically will not be substantially related to fluctuations in the value of natural gas.

In the energy markets, it is common for companies to hedge multiple commodity risks, such as an electric utility hedging the commercial risks of its input (natural gas as fuel) and output (electric generation / deliverable electric energy). Cross-commodity hedging is also commonplace due to correlations between commodities. The correlation can often be highest out the curve with the correlation decreasing in the spot month. The Commission's proposed quantitative factor inappropriately measures correlation only between the spot prices of the target commodity and the spot prices of the commodity underlying a derivative contract to determine whether a cross-commodity hedge meets the rebuttable presumption of a *bona fide* hedge. This is not the same analysis that the exchanges or market participants use to make commercial judgments about the appropriateness of cross-commodity hedges. In certain commodities, the correlation between the target commodity and the commodity derivative contract is higher farther out the forward price curve. As such, using spot prices to make a correlation determination is problematic. For example, many market participants hedge long-term electricity price exposure with natural gas futures contracts because there is no liquidity in deferred electricity futures contracts. In addition, electricity futures contracts tend to have increased volatility in the spot month. As a result, most cross commodity hedging activity is done prior to the delivery month with market participants converting hedges to electricity futures contracts as the risk moves closer to or into the spot month. As such, using spot prices to make a correlation determination is problematic and could distort the correlation analysis. ICE believes the Commission should instead evaluate correlations in non-spot months further from expiration as this timeframe supports a more accurate correlation period and result for the cross commodity hedge correlations.

In addition, the quantitative test of correlation is not the appropriate measurement to allow the use of cross-commodity hedges. For example, when market participants hedge power with natural gas, they measure delta and delta hedge to offset the economic exposure of changes in power using natural gas because it is more liquid. If correlation testing is going to be part of the process, ICE believes the Commission should use a prospective test using the correlation of forward markets between the underlying and commodities beyond the spot month. Moreover, ICE recommends the Commission justify the 0.80 threshold and recognize that correlation out the curve is the relevant measure, not the spot month. In less liquid markets, the 0.80 is a difficult standard to meet.[14] Market participants engaging in hedge transactions should have flexibility to use a variety of tools for risk management and should not be constrained in this regard. ICE proposes that the Commission permit market participants to make commercially reasonable determinations of which contracts are substantially related rather than defining "substantially related" and requests that the Commission eliminate the proposed quantitative factor. By subjecting the cross commodity exemption to an 80% correlation, market participants' ability to

[14] ICE tested various cross commodity pairings using **non-spot** month data and found many pairings were still unable to meet the .80 correlation test. Upon request, ICE will provide this correlation data.

claim this exemption will be severally limited thus increasing price volatility and market participant risk.

Trade Options

The Commission proposes to subject Trade Options to position limits and considers Trade Options to be physical-delivery Referenced Contracts. ICE requests that the Commission exclude trade options from the definition of a Referenced Contract. Trade Options are commercial merchandising transactions done by companies in the normal course of business. They are not in the nature of speculative transactions and do not lend themselves to market manipulation. As such, ICE believes the Commission has an obligation to consider carefully the benefits and associated costs with any rulemaking in light of applicable statutory directives. Any rulemaking addressing position limits must account for the complexity of the products regulated and the tangible benefit of the regulation and be cost efficient. Trade Options are complex instruments which would require great expense to monitor and aggregate into position limits. Most Trade Options are not currently modeled in companies' risk management systems and the expense of compliance with the requirement would be great. There is little tangible benefit to subjecting Trade Options to position limits and no detrimental consequences by not including them in the definition of Referenced Contracts. Given these realities, our view is that including Trade Options in the definition of Referenced Contract would be costly and unnecessary.

It is also important to consider that the Commission currently does not have data on the open interest or deliverable supply estimates of Trade Options and thus cannot assess how the proposed spot and non-spot month limits would impact Trade Options. Due to the depth of variation between Trade Options it is extremely difficult to assess the open interest or deliverable supply estimates. Additionally, data on Trade Options was not considered by the Commission when setting levels for non-spot month limits, which could adversely impact market participants who hold positions in both physically-settled contracts and Trade Options. The 2011 position limit rule also did not explain or consider the consequences of treating commodity Trade Options as Referenced Contracts subject to speculative position limits, nor did it suggest how subjecting physical supply option contracts to position limits would be feasible. The inclusion of Trade Options could result in long-term deals counting toward the non-spot month limits, making it difficult, if not impossible for a commercial market participant to stay below the non-spot month limits. In addition, implementing a position limits compliance program that includes commodity Trade Options would be particularly challenging because of, among other things, the difficulty many market participants have had in distinguishing between Trade Options, forwards, and swaps.

Lastly, if the Commission considers Trade Options to be physical-delivery Referenced Contracts, holding a Trade Option prohibits market participants from availing themselves of the Conditional Limit on cash-settled contracts. This would be a drastic change from the current Conditional Limit exemption. Presently, physically-settled contracts are solely defined as

physically-settled futures contracts. Modifying this definition will limit market participant's ability to hedge their risks and reduce spot month liquidity.

Conclusion

ICE appreciates the opportunity to comment on the proposal. As written, the proposed rule makes substantial changes to the current position limit regime and differs greatly from the 2011 final position limit rules. We strongly suggest that the Commission exercise great caution in making changes to a well-functioning market. We also suggest that the Commission analyze the impact of the current (and new) position limit regime for energy markets before implementing this rule. If the Commission decides to go forward with this rule, we suggest that the Commission remove the onerous requirements on bona fide hedging, spread, arbitrage and cross commodity exemptions that impact hedgers which we believe are contrary to the Commodity Exchange Act.

Again, ICE thanks the Commission for the opportunity to comment on the proposed rules.

Sincerely,

Kara Dutta
IntercontinentalExchange