February 10, 2014

Melissa Jurgens
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

RE: Position Limits for Derivatives, RIN 3038–AD99

Dear Secretary Jurgens:

Noble Americas Resources Corp. ("NARC") submits the comments below in connection with the Commodity Futures Trading Commission's ("CFTC" or "Commission") notice of proposed rulemaking entitled, "Position Limits for Derivatives" (the "Proposed Rule"),[1] which sets out the Commission's proposal to revise federal position limits.

NARC is a U.S. subsidiary of the Noble Group Limited ("NGL"), a leading global supply chain manager of agricultural, energy, metals, and minerals products headquartered in Hong Kong. NGL and its subsidiaries, such as NARC, operate as a global commodity merchant and logistics manager ("merchant"), connecting producers of physical commodities to high demand growth markets. In addition to its physical supply chain activities, NGL owns sugar production facilities in South America and operates cotton warehouses in North America. NARC operates at the intersection of the physical and financial markets to meet the physical supply needs of producers and consumers.

I. INTRODUCTION.

NARC appreciates the opportunity to comment in this proceeding. While it supports the Commission's goal to prevent excessive speculation in the commodity markets, NARC is concerned that the Proposed Rule will significantly and adversely affect its core business in providing physical commodities, such as coffee, sugar, and cotton, to industrial and commercial end users. Specifically, NARC believes that, if the Proposed Rule is finalized as proposed, NARC's ability to hedge its physical exposures will be severely harmed. Even more concerning, the Proposed Rule will shift and potentially distort the existing balance between buyers (merchants/end users) and sellers (merchants/producers), impairing the price discovery function that all expect from the market. As all merchant firms similar to NARC

[1] *See Position Limits For Derivatives*, 78 Fed. Reg. 75,680 (Dec. 12, 2013).

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will be burdened, the ultimate consumers of commodities likely will be negatively impacted as well. Thus, NARC submits the following modifications should be made to the Proposed Rule:

1. The exemptions for bona fide hedging transactions should include an exemption for hedges of anticipated merchandising activity.

2. The specific bona fide hedging exemption for positions that hedge unfilled anticipated requirements and unsold anticipated production should eliminate the restriction that hedges not exceed twelve months of unfilled anticipated requirements or unsold anticipated production, respectively.

3. The restriction in several bona fide hedging exemptions on holding physical-delivery referenced contracts into the spot month must be eliminated.

II. BONA FIDE HEDGING EXEMPTION FOR HEDGES OF ANTICIPATED MERCHANDISING.

The Commission has long recognized that (i) commodity markets serve the needs of consumers and producers of physical commodities, and (ii) merchants play a key role in the physical supply chain, providing liquidity and suppressing costs to consumers. Indeed, the CFTC's historical policy and previous rulemaking that established federal position limits under Part 151 of its regulations, while vacated, included a bona fide hedging exemption for anticipated merchandising.

Merchants solve two major challenges in the physical commodity markets. *First*, producers may wish to sell their off take at times there may not be willing buyers. *Second*, although seasonal cycles exist, the exact timing of buying and selling is unpredictable. For example, recently, the market price of coffee jumped 25% in four days. Not surprisingly, there were several more sellers than buyers interested in trading long term structures. A merchandiser, such as NARC, may utilize its storage capacity and physical supply chain expertise to buy the excess supply and sell the physical commodity to buyers when they desire to transact in the physical market. Thus, a merchandizer effectively bridges the gap between timing mismatches of supply and demand fundamentals.

It would be impossible for a participant in the middle of the value chain to precisely match the acquisition of every bushel or bag with the sale of that exact bushel or bag. However, a merchant adds value to the supply channel for commodities with their knowledge of trends in the production, transportation, storage, and consumption of commodities. By anticipating trends, they are able to manage price risk well ahead of production or consumption of a particular commodity. Without a bona fide hedging exemption from the federal position limits regime for anticipated merchandising, the orderly and efficient operation of the cash markets for commodities will be eroded.

While the Commission may be concerned market participants will abuse bona fide hedging exemptions, it could extend the Form 704 reporting requirement to anticipated merchandising exemptions and provide the necessary safeguards to prevent such abuse. The Commission

would have the authority to request additional information to support the claimed bona fide hedging exemption and simply reject the request for an anticipatory hedge exemption.

Accordingly, NARC requests the Commission to expand the bona fide hedging exemptions to apply to hedges of anticipated merchandising. If the final version of federal position limits does not contain an enumerated bona fide hedging transaction for such commercial market activity, the merchant participant could not perform its valuable market function without incurring unreasonable risks and costs. In support of this request, NARC presents the following comments to demonstrate the necessity of merchandising activity in the agricultural markets and the ability to hedge price risks associated with this activity.

A. Cash and Carry.

Cash and carry trades historically have allowed NARC coffee traders and other merchants to reduce uncertainty in wholesale producer/consumer trading patterns. Specifically, cash and carry trades facilitate the sale of cash commodities by producers in the short term. The cash and carry trade works when current prices are lower than observable prices in forward months. Very simply, the cash and carry trade occurs when a merchant sees that the cost of purchasing a commodity in the near market, along with the costs of storage, insurance, and financing, among other things, is less than the price for future delivery. Upon seeing the opportunity, the merchant will then purchase the commodity and store it (incurring costs that the producer no longer has to bear). The merchant will often enter the derivatives markets to hedge the current sale price or the future sale price. The exchanges have historically provided exemptions from position limits to permit such transactions, recognizing the value to the underlying cash commodity markets in allowing merchant participants to come into the futures markets to manage risks in the cash and carry trade.

Under the position limits regime that appears in the Proposed Rule, hedges associated with the cash and carry transaction may not constitute bona fide hedging transactions. This result would constrain the use of the cash and carry trade, which would negatively affect the underlying cash markets. NARC and other merchant firms should be able to hedge inventory to accommodate spot month price volatility and ensure price convergence between the physical and financial markets.

In light of the above, the Commission should explicitly address the use of derivatives in connection with the cash and carry trade such that any final federal position limits adopted in this proceeding preserve the common use of this valuable trade. NARC advocates that qualifying hedges for the cash and carry trade be allowed in markets where the cash and carry trade has historically occurred, such as the coffee markets, and not for every market. That is, NARC urges the Commission to preserve the *status quo*.

B. Variable Price Transactions.

The Proposed Rule states that a market participant has not assumed price risk if it has not (i) acquired inventory or (ii) entered into fixed-price purchase or sale contracts, even when the merchant reasonably anticipates the purchase and sale of a commodity in the future.

Moreover a commodity derivatives contract that reduces this "yet-to-be-assumed" risk would not constitute a bona fide hedging transaction.[2] The Commission should abandon such an overly simplified view of risk, particularly for purposes of categorizing transactions as bona fide hedging transactions. In addition, the Commission should style a definition of "bona fide hedging position" that captures any derivative that abates risk in a commercial enterprise.

The Commission's view does not reflect legitimate and commonly used commercial hedging practices in the agricultural commodity markets, including coffee, sugar, and cotton markets. Importantly, physically settling derivatives contracts hedge supply risk. Often, as customary in commodity markets, such contracts use index pricing. For example, currently, the U.S. supply of cotton is constricted due to lower production and increased global demand for U.S. production. As a result, market participants, primarily end users, expecting cotton to continue to be scarce, are procuring cotton from merchant participants, typically at variable prices (*i.e.*, floating or index). Due to the scarcity of U.S. cotton, prices have risen and end users, uncertain about future demand, are electing to "roll" purchase commitment pricing forward on the curve. However, the merchant participant's obligation to deliver goods within the original period remains. A significant problem would arise if cotton production was not readily available and merchant participants were unable to use futures contracts as a potential source of goods. In other words, there is no reason why long hedges should not be recognized as bona fide hedges simply because the pricing has not been fixed on the forward curve.

Another example would include physical commodity due for delivery in March and indexed to the July futures month. In this case, a merchant participant would need to procure goods for delivery in March even if the end user has not fixed the final price. A common industry solution is to provisionally invoice the goods in March and allow the price to remain floating until such time the end user is comfortable fixing the price. Thus, the derivatives contract serves a wholly different purpose than abating fixed-price risk. Here, the derivatives contract reduces floating price risk for supply transaction. The Commission should allow market participants to hedge risk as they see fit, including floating price risk, and receive bona fide hedging treatment.

NARC uses index price transactions to manage its market risk associated with its obligations to supply, among others, coffee, sugar, and cotton to consumers. If the Commission did not permit it to hedge its floating or index price risks, it ultimately would increase consumer prices for the particular commodity or force NARC not to engage in its physical supply chain function.

III. Bona Fide Hedging Exemption for Unfilled Anticipated Requirements and Unsold Anticipated Production—The 12-Month Limitation.

NARC generally supports a bona fide hedging exemption for hedges of unfilled anticipated requirements and unsold anticipated production. In addition to performing a merchant

[2] Proposed Rule at 75,718.

function, NARC has businesses in the production of sugar and the warehousing of cotton, among other things. The bona fide hedging exemption for hedges of unfilled anticipated requirements and unsold anticipated production is important for the efficient operation of the commodities markets. The Commission might improve upon this exemption as it appears in the Proposed Rule by eliminating the limitation on positions held in agriculture commodities not to exceed 12 months of requirements or production.[3]

The proposed hedging exemption does not reflect commercial operations, such as agricultural planting cycles for certain commodities. Many farmers like to lock in their profits before they plant their crop. Some crops have a twelve-month growing cycle (or shorter), and hedging based upon a twelve-month period may be adequate. In contrast, some crops, like the following three examples, need to be hedged more than twelve months out.

Sugar Cane. Sugar cane plants (which provide 81% of the world's sugar) have a three- to five-year life cycle. Sugar growers need to lock in their profits through three- to five-year contracts.

Coffee. Coffee trees typically have multi-year growing cycles, and wholesale buyers may purchase coffee several years in advance, so the ability to hedge more than twelve months is desirable.

Cotton. Although cotton is an annual plant, cotton production often exists in the southern hemisphere causing cotton growing cycles to be six months ahead of the U.S. growing cycles, and cotton demand is driven by the northern hemisphere, resulting in an eighteen-month hedge cycle. Additionally, many cotton farmers are required to lock in two years of profits to obtain financing before committing a field to cotton production. These cotton farmers need to lock in their profits through multi-year contracts.

The Commission should not limit the anticipated unfilled requirements or unsold production bona fide hedging exemptions to twelve months for agricultural commodities. For the

[3] Specifically, the definition of bona fide hedging position in proposed regulation 150.1 provides in relevant part:

(iii) *Hedges of unfilled anticipated requirements. Provided that* such positions in a physical-delivery commodity derivative contract, during the lesser of the last five days of trading or the time period for the spot month in such physical-delivery contract, do not exceed the person's unfilled anticipated requirements of the same cash commodity for that month and for the next succeeding month:

(A) Long positions in commodity derivative contracts that do not exceed in quantity unfilled anticipated requirements of the same cash commodity, and that **do not exceed twelve months for an agricultural commodity**, for processing, manufacturing, or use by the same person

. . . .

(i) *Hedges of unsold anticipated production.* Short positions in commodity derivative contracts that do not exceed in quantity unsold anticipated production of the same commodity, and that **do not exceed twelve months of production for an agricultural commodity**, by the same person.

(emphasis added).

commodities described above, the ability of all market participants to hedge risk beyond twelve months is fundamental to the efficient operation of the cash commodity markets. If the Commission retains the twelve-month restriction, smaller producers will be disadvantaged, as they will be unable to finance and invest in future crops because of the limitations on their hedging. This could have the unintended consequence of limiting supply and concentrating liquidity in a smaller percentage of market players.

IV. SPOT MONTH RESTRICTION.

Several enumerated bona fide hedging positions, including the cross-commodity hedging position, prohibit market participants in agricultural markets from holding physically-delivered referenced contracts during the spot month (the "five-day rule"). This requirement will inappropriately restrict commonly used risk-reducing activity in the agricultural markets and has no discernible operational or economic benefit. The five-day rule would only make sense to protect the physical delivery process of a single exchange. However, as the federal position limits rule applies position limits across multiple exchanges and the over-the-counter markets, the purpose of the five-day rule is not certain. The Commission's retention of the five-day rule in the Proposed Rule appears to be a carryover from past regulations, but without the underlying need. Accordingly, NARC recommends that the five-day rule be eliminated from all enumerated bona fide hedging transactions in the final rule for federal position limits.

NARC and other physical supply chain merchants regularly transact index price physically-delivered referenced contracts to efficiently manage physical supply flows to producers and consumers. They often need to hold these contracts during the spot month because wholesale producers and consumers like to wait until the last trading day to fix the price.[4] If these physically-delivered index price referenced contracts were not permitted to be held during the spot month, and market participants were forced to enter into cash-settled contracts, they would bear full exposure to price risk during the physical delivery period, as cash-settled contracts do not go to delivery and settle before expiry of physical-delivery referenced contracts. Therefore, the Commission should eliminate the five-day rule from any bona fide hedging exemption.

V. CONCLUSION.

NARC appreciates the opportunity to provide these comments and requests the Commission's consideration of them as it develops a final rule in this proceeding. We would like to reserve the ability to submit additional comments following the review of other comments in this rulemaking proceeding, particularly given the anticipated length and complexity of several of these comment letters.

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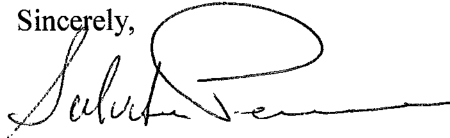
[4] Indeed given the number of weeks required for the delivery of cotton, many cotton mills will prefer the index price futures contract not to be fixed until they have received the cotton, which can be more than two months after the futures contract expires.

If you have any questions regarding any of the comments provided herein, please contact the undersigned at (203) 326-8121 or SalvatorePenna@thisisnoble.com.

Sincerely,



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