



By Commission Website

August 4, 2014

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

Re: Position Limits for Derivatives (RIN 3038-AD99)

Dear Ms. Jurgens:

Thank you for the opportunity to submit these comments in connection with the above-referenced notice of proposed Rulemaking establishing speculative position limits for agricultural and exempt commodities. As background, Olam International Limited (“Olam”) is a worldwide agribusiness that engages in the production, processing and/or merchandising of a wide variety of agricultural commodities, including: cocoa, coffee, cotton, sugar, grains and dairy products. Olam uses a variety of U.S. and non-U.S. exchange traded futures, options and over-the-counter derivatives to hedge its cash market exposure. This letter reiterates and reincorporates by reference the views expressed in our prior comment letter on this topic dated February 10, 2014 (the “Prior Letter”). We have a few additional comments on the following matters only. For your convenience, we are structuring our response to parallel the staff questions regarding gross hedging, anticipatory merchandising and the hedging of unfixed price purchase and sale commitments posed during the Commodity Futures Trading Commission (the “Commission”) Roundtable on June 19, 2014 (the “Roundtable”).

I. Market Participants Should Remain Free to Separately Hedge Cash Market Positions Regardless of Their Net Cash Market Position

Interpretive guidance set forth in the proposed position limit rules would limit commercial market participants’ ability to engage in gross hedging (*i.e.*, the separate hedging of long and/or short cash market positions). From questions asked by staff at the Roundtable, it appears that the Commission may be concerned that a market participant with both long and short cash market exposure may increase their overall risk by hedging only one side of their cash market position. Nonetheless, we believe that gross hedging is economically appropriate in a variety of circumstances and that the Commission’s proposal will limit market participants’ ability to hedge the risks associated with their commercial activities. This potentially will result in increased costs and volatility that could detrimentally impact us and lead to higher prices for consumers.



Further, maintaining the current standards for gross hedging and allowing exchanges to continue to assess the economic appropriateness of a hedge exemption request would address the Commission's concerns and provide a clear standard for distinguishing bona fide hedging and speculative positions.

A. Gross Hedging is Economically Appropriate to the Reduction of Risks in a Commercial Enterprise

In the proposed rule, the Commission issued interpretive guidance indicating that a market participant may only engage in gross hedging if it hedges both its long and short cash market exposure. As described in our Prior Letter, this interpretation conflicts with the Commission's longstanding guidance on gross hedging and the Commission's practice of allowing market participants to hedge their long or short cash market exposure regardless of their net position. As the Commission has previously recognized, "net cash positions do not necessarily measure total risk exposure due to differences in the timing of cash commitments, the location of stocks, and differences in grades or types of the cash commodity."¹

As we wrote in our Prior Letter, the Commission's proposal could materially and adversely impact the ability of each of our affiliates to maintain distinct hedging programs. This would also necessitate a substantial change to our operations by forcing us to establish a central trading desk.

During the Roundtable, Commission staff expressed a concern that a market participant may hedge only one side of its cash market position for an improper purpose and posed the following scenario. Assume: (i) the all months combined limit for a particular commodity is 20 contracts; (ii) a trader has entered into a fixed-price purchase for the equivalent of 50 contracts of a commodity in three months; and (iii) the trader has entered into a fixed-price sale for the equivalent of 50 contracts of the commodity in six months. The Commission then inquired whether it would be appropriate for the trader put on a long, spot-month futures position as a hedge for the fixed-price sale. We respectfully submit that hedging only the fixed-price sale would be economically appropriate if the trader expects to sell 50 contracts worth of the commodity in the local spot market between months three and six months.

Merchants, like us, often carry inventory at regional operations that is sold in the local spot market. Many of these sales do not result from a fixed-price sales contract, but rather, arise from a customer's immediate need for a commodity. A merchant may, based on the current market conditions, its historical sales or other factors, know or have reason to believe that it will sell a particular quantity of a commodity in the local cash market over a given period.

¹ Definition of Bona Fide Hedging and Related Reporting Requirements, 42 Fed. Reg. 42748, 42750 (August 24, 1977)



Assume, for example, that based on its average sales over the past year, the trader in the scenario described above, expects to sell $16 \frac{2}{3}$ contracts worth of the commodity per month in the local cash market between months three and six. The trader, therefore, views his position as long 50 contracts through the fixed-price purchase contract, short 50 contracts in expected spot-market sales and short 50 contracts through the fixed-price sales contract. In this scenario the trader needs to offset the fixed-price sale by putting on a long 50-lot futures position. This represents a bona fide hedge.

Under the Commission's interpretive guidance, the trader would be viewed as having a speculative position of 50 contracts. This is wrong. If the trader failed to purchase 50 futures contracts it would, in fact, leave the merchant's exposure unhedged.

To avoid a position limit violation, the trader would need to limit its futures position to 20 contracts (increasing its overall risk exposure) or hedge its fixed-price purchase until the spot market sales occur and then hedge its fixed-price sales contract. If the trader is required to hedge its fixed-price purchases through a short futures contract until the cash market sales have occurred, it will be subject to basis risk (*i.e.*, the risk associated with changes in the difference between the futures price and the cash market price). In many instances, the basis risk and transaction costs associated with maintaining a futures position exceed the price risk that the market participant would have otherwise incurred.

The scenarios described above, in our Prior Letter and during the Roundtable are just a few of countless examples that demonstrate the necessity of gross hedging. Failing to grant these positions bona fide hedging treatment could increase the risks of commercial operations and may lead to increased costs and volatility for merchants and higher prices for consumers.

Further, the Commission's proposed interpretive guidance may have other unintended consequences such as limiting commercial participants ability to obtain the beneficial margin treatment afforded to hedging transactions thereby also increasing merchants' costs.

B. The Commission Should Permit Gross Hedging and Continue to Allow the Exchanges to Assess the Economic Appropriateness of a Particular Position

During the Roundtable, the Commission asked market participants what standard should be applied to differentiate hedging positions from speculative positions and what documents could be produced to support the risk reducing nature of a hedging position. We respectfully submit that the Commission should continue the longstanding practice of allowing market participants to hedge their gross positions irrespective of their net positions. This standard is clear, effective and can be supported by position information already submitted to the Commission.

As described above, the Commission's interpretive guidance regarding gross hedging is both over inclusive and under inclusive. The guidance is under inclusive as it would fail to afford

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bona fide hedging treatment to numerous positions and transactions that are economically appropriate to the reduction of risks in a commercial enterprise and over inclusive as it may provide bona fide hedging treatment to positions that increase overall risk. Rather than adopt such as standard, the Commission should allow exchanges to continue to assess the economic appropriateness of hedge positions or transactions in connection with their review of hedge exemption requests. This process requires market participants to explain why their hedging strategy is economically appropriate while providing the flexibility necessary to manage the complex and changing risks of their operations. It also gives the Commission assurance that requests for gross hedge exemptions will not be abused because of the more intimate familiarity of exchanges with trading practices.

II. The Commission Should Adopt a Hedge Exemption for Anticipated Merchandising Activities

The Commission did not include anticipated merchandising as an enumerated hedge in the proposed position limit rule. The statutory definition of bona fide hedging position includes “assets that a person owns, produces, manufactures, processes, or *merchandises*, or *anticipates* owning, producing, manufacturing, processing, or *merchandising*.”² As such, we respectfully submit that the Commission is required to provide an enumerated hedging exemption for anticipatory merchandising.

Among other types of anticipated merchandising, the Commission should provide bona fide hedging relief for positions used to hedge unfixed-price contracts. Price risk is just one of many risks faced by merchants like us. A merchant is required to fulfill a contractual obligation regardless of whether the price is fixed on the day the contract is executed or the day prior to delivery. Merchants should be granted bona fide hedging relief when they establish a position in a physically delivered contract that is intended to offset their performance risk even if on an unfixed price contract. Granting an anticipated merchandising exemption for unfixed price contracts would not only reduce operational risk it would also encourage price convergence by allowing market participants potentially to acquire a commodity through the delivery process when taking delivery is cheaper than purchasing the commodity in the cash market. An obligation to deliver or take delivery under a contract is an obligation whether the price is set at the time or not.

III. Conclusion

Thank you again for the opportunity to submit these comments.

For the reasons set forth above we respectfully request that the Commission reaffirm its longstanding guidance that a market participant may hedge its gross cash market positions regardless of its net position and add an enumerated hedging exemption for anticipated merchandising.

² CEA Section 4a(c)(2)(A)(iii)(I) (emphasis added).



If the Commission has any questions regarding the matters discussed above, please contact the undersigned at 908-988-1928 or Stephan.Ariyan@Olamnet.com.

Sincerely,

A handwritten signature in blue ink that reads "Stephan Ariyan" followed by a stylized monogram.

Stephan Ariyan

Vice President, Market Compliance and Chief Compliance Counsel