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August 4, 2014

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:

Intercontinental Exchange, 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.

First, Do No Harm

The proposed position limits differ considerably from the final rules issued by the Commission in 2011 and will likely impact commercial participation in the referenced contracts.

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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 expanded over the past 10 years. Following high energy prices in 2007 and 2008 we have seen increased investment in energy production and transportation. As a result of this expansion, there is increased participation in the energy markets. Given these facts, 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."[1] Commercial market participants use futures, options, and swaps to hedge their commercial risk and otherwise operate their businesses. In doing so, they attempt to employ the most cost-effective techniques to optimize and risk-manage their businesses. Designated contract markets ("DCM") and over-the-counter ("OTC") swap and physical markets have functioned efficiently and permitted commercial companies to make informed choices regarding the products they will use to manage risk in their commercial businesses. Given the current market practices of commercial market participants and the robust and well-functioning markets currently in place, ICE strongly suggests that the Commission sufficiently provide flexibility for commercial market participants to mitigate risk in connection with their business.

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

[1] 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).

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 the CFTC properly setting and administering 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. 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. ICE also believes that deliverable supply is the appropriate basis for setting limits but, as described below, believes that limits for cash-settled contracts should be set at a level higher than physically-delivered contracts.

Congress 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 recommends the Commission continue to gather additional data regarding the OTC swaps markets so that the Commission can make a more informed decision regarding position limits in the future. 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.

The contracts today and the Conditional Limit recognize these differences. Market participants access each contract for a distinct reason. Cash- settled contracts transfer price risk as the vast majority of market participants do not want the risk of physical settlement, but they want exposure to the final settlement price. 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. For these reasons, it is appropriate for the Commission to set limits higher for cash settled contracts in the spot month.

Conditional Spot Month Limit for Financially Settled Contracts Must be Maintained and Expanded to all Contracts

Since February 2010, the CFTC required each commodity contract that cash-settles against the final settlement price of a corresponding physically delivered contract to have the same spot-month position limit as that corresponding contract. However, in recognition of the facts that trading in cash-settled contracts have negligible ability to influence the final settlement price of the corresponding physically-delivered contract, and that Dodd-Frank changes are pushing significant volumes of cash-settled contracts that had long existed in the OTC markets into exchanges and clearinghouses, the CFTC added a Conditional Limit provision that allowed participants in financially-settled natural gas contracts to take a position up to 5 times the physically-settled natural gas contract's position limit if the participant does not hold a position in the natural gas physically settled contract. 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 went into effect, the natural gas markets have demonstrated stable pricing, model convergence and low volatility. Convergence in the natural gas market is more efficient than other commodity markets. Under the Conditional Limit, the natural gas market has seen nearly perfect convergence with an average price differential of less than a penny. Contracts for corn, soybeans and wheat, on the other hand, have an average convergence up to ten times higher. Average spot month volumes in the NYMEX physically-settled natural gas contract have been strong and indicative of an efficient market. Trading and open interest in the NYMEX physically settled contract has also increased. Dozens

of firms have used the Conditional Limit in natural gas since its inception allowing commercial firms reliant upon cash-settled hedges to find the necessary liquidity and counterparties. ICE has received no complaints regarding natural gas markets during this timeframe nor are we aware of any complaints received by CME or the CFTC.

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 and harm liquidity in the cash market increasing the cost of hedging and possibly preventing convergence between physical and financial markets. Eliminating or decreasing the Conditional Limit for cash-settled contracts would also 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 DCMs, swap execution facilities ("SEF"), and the bilateral OTC market. The conditional limit avoids unnecessarily limiting liquidity and price discovery with negligible potential to impact the final settlement price of the physical contract and has the beneficial effect of encouraging end users with large positions to move their positions to cash-settled contracts. 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. 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.

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 supply estimates. ICE supports using alternative estimates for deliverable supply which update deliverable supply to reflect current market circumstances.[2] Over the past decade, the domestic energy infrastructure has grown substantially; therefore, it follows that deliverable supply estimates should also increase. As deliverable supply estimates have increased, levels of

[2] 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.

participation in the energy markets have also increased. ICE believes that the Commission should adjust the Proposed Rule to accommodate for these increased levels of market participation. Furthermore, 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. ICE urges the Commission to adopt revised deliverable supply estimates which reflect current market conditions.

Increased Deliverable Supply Estimates does not Eliminate the Need for the Conditional Limit

ICE supports deliverable supply estimates which accurately reflect the physical markets. Increased deliverable supply indicates healthy and robust domestic energy markets. The increase in deliverable supply also indicates an increased volume of product to hedge. The position limit rules need to accommodate for these increased levels of market participation specifically by maintaining the Conditional Limit. Increased deliverable supply does not eliminate the need for the Conditional Limit.[3] In fact, just the opposite, it is necessary to maintain liquidity in an already constrained market. Market participants have voiced concerns that they are already constrained at certain locations due to all exchange traded energy contracts having position limits and large liquidity providers exiting the market.[4] In addition, the Proposed Rule itself effectively halves the present position limit in the spot month by aggregating across trading venues and uncleared OTC swaps. Coupled with the potential for a more restrictive bona fide hedge definition and limited hedge exemptions, the limits will be substantially lower than in place today. Increased hedging needs, coupled with a lower position limit to hedge against is a dangerous combination.

Moreover, the futures markets serve to transfer price risk from one person to another. Cash settled contracts transfer price risk as the vast majority of market participants do not want the risk of physical settlement, but they want exposure to the final settlement price. Cash settled contracts are much less susceptible to manipulation and the size of a position does not impact deliverable supply. Holding positions up to 125% has had no adverse consequences with supply

[3] Sarah Tomalty, on behalf of the Natural Gas Supply Association, at the Position Limits roundtable on June 19, 2014, said that deliverable supply estimate data are missing a "big piece of the market" and supports raising the deliverable supply estimates and a higher cash settled limit.

[4] As noted by Sarah Tomalty from the Natural Gas Supply Association at the Position Limits roundtable, Henry Hub has a robust and liquid market in contrast to many other natural gas delivery points which are currently constrained for liquidity.

constraints and underlying physical delivery contracts. As such, it is appropriate to have limits for cash-settled contracts in addition to the revised deliverable supply estimates.

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.[5]

The Commission should consider alternate means for setting these limits in contracts which have a small open interest, as it could hamper growth of the market. In addition, the proposed formula could result in aberrations where the deliverable supply underlying a contract is large, because the spot month limit determined on the basis of that supply could be greater than the single month and all months limits that are based on open interest. In such cases, the listing exchange should have the flexibility to set non-spot month limits on an alternative basis that does not have the effect of unduly restricting trading in non-spot months. For example, at a minimum, the exchange should be able to set these limits at the same level as the spot-month limit.

The Commission should also 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 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

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

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.[6]

[6] 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.

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 continue to allow higher limits for cash-settled contracts and sufficiently provide flexibility for commercial market participants to mitigate risk in connection with their business.

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

Sincerely,

Kara Dutta
IntercontinentalExchange