



January 22, 2015

Christopher Kirkpatrick  
Secretary of the Commission  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21<sup>st</sup> Street, NW  
Washington, DC 20581

RE: Position Limits for Derivatives  
RIN 3038-AD99

Dear Mr. Kirkpatrick,

ICE Futures U.S. (“ICE Futures” or the “Exchange”) appreciates the opportunity to submit additional comments on the proposed rulemakings issued by the Commodity Futures Trading Commission (“CFTC” or “Commission”) setting forth new rules on position limits for derivatives. ICE Futures is a U.S. designated contract market owned by Intercontinental Exchange, Inc. which is the leading global network of regulated exchanges and central counterparty clearing houses for financial and commodity markets. This letter supplements comments submitted by the Exchange on February 10, 2014 and August 4, 2014.

As background, the Exchange lists contracts in a broad array of international, soft agricultural commodities, including sugar, coffee, and cocoa, as well as contracts in legacy commodities, such as cotton. ICE Futures and its predecessor exchanges, which date back to 1870, have a strong history of working with the Commission to review position limits and exemption requests for the Cotton No. 2 contract while overseeing position limits, accountability levels and exemption requests for the Coffee “C”<sup>®</sup>, Cocoa, Sugar No. 11<sup>®</sup>, FCOJ-A and Sugar No. 16 futures and options contracts. This extensive, direct experience has guided the Exchange’s evaluation of the implications of the proposed rulemakings to the maintenance and oversight of these markets by ICE Futures.

The proposed rules are rooted in, and generally extend, the program that currently exists for the enumerated agricultural commodities, such as cotton and wheat, to numerous other commodities including World sugar, coffee and cocoa. Some aspects of the current and proposed rules are based on a definition of bona fide hedging that was largely developed decades ago, driven by practices in domestic agricultural markets. That

approach cannot reasonably be expected to properly account for commercial market practices that have evolved over time in both domestic and international markets.

The Commission has limited the definition of bona fide hedging position in the proposed rules and set forth a specific, narrow list of enumerated hedging positions that will be recognized. In doing so, the Commission will prohibit long-standing risk management practices which are authorized by the Commodity Exchange Act (“CEA”) and which have been used by commercial market participants for decades to manage the numerous types of risk encountered in their commercial activities, including, but not limited to, price, time, quality, location and counterparty. While the rules permit applications for non-enumerated hedges, they do not provide a process with firm time limits for the Commission or its staff to act upon requests from market participants for non-enumerated hedging exemptions, and there is no assurance that any would be granted by the Commission. The limitation on the definition of bona fide hedging position coupled with the absence of an effective administrative process and commitment to grant non-enumerated hedge exemptions is likely to have an adverse effect on commercial market participants.

#### Unfixed Price Commitments as Hedging Transactions

The proposed rules ignore commercial market practices in the Exchange’s commodities in other important respects. For example, the proposed rules recognize offsetting unfixed-price cash commodity sales and purchases<sup>1</sup> as hedging transactions provided that the positions are not held in any physical-delivery commodity derivative contract during the lesser of the last five days of trading or during the period the spot month position limit applies in such contract. However, physical contracts for cotton may permit prices to be fixed into the notice or delivery period and this restriction has caused problems for commercial market participants in the cotton market as the Commission has advised the Exchange that it cannot grant cotton spot month exemptions for unfixed-price contracts.

The failure to fully recognize unfixed-price commitments as hedging transactions has additional negative implications for commercial market participants in cotton, as illustrated by the two examples below.

Example 1: A merchant has sold 100,000 bales on-call with the price based on the March 2016 contract to a mill for delivery in January 2016. The merchant tries to procure the cotton in the market, but is unable to do so, thus he decides to take delivery of the December 2015 contract in order to fulfill his delivery obligations for January 2016. However, under the current and proposed rules the merchant would not qualify for a hedge exemption because the commercial sales contract is not fixed-price. The rules fail to recognize that the sales obligation exists, whether the price is fixed or not.

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<sup>1</sup> Unfixed-price contracts in the commercial cotton market are known as On-Call purchases and sales.

Example 2: A merchant has 2,000,000 bales of on-call purchases from various producers with the price based on the December 2015 contract. The price spread between the December 2015 and July 2016 contracts is in contango, so that the price of the December contract is at enough of a discount to the July contract to allow full financial carry from December to July. The merchant would like to lock-in this financial carry, thus mitigating risk exposure to the December contract, by buying 20,000 lots (the equivalent of the on-call purchases) of the December contract and selling the same quantity of the July contract. However, under the current and proposed rules, the merchant could not buy the contracts because this transaction is not recognized as a bona fide hedge. Thus, the merchant cannot use a risk management strategy that he believes is commercially appropriate to manage his exposure to the December contract.

The Commission has not fully articulated the rationale for not viewing unfixed-price commitments as bona fide hedges except in the very limited circumstances specified; therefore the Exchange and commercial market participants do not have a good understanding of why the Commission believes that the transactions described above should not qualify as bona fide hedges and believe the Commission should reconsider its position.

#### Anticipatory Hedges

The proposed definition of bona fide hedging enumerates two transactions that are currently used by commercial entities utilizing Exchange contracts to hedge their commercial risks. These positions are hedges of unfilled anticipated requirements and hedges of unsold anticipated production. However, the proposed rules impose a restriction of twelve (12) months of anticipated requirements and anticipated production--which conflicts with the hedging programs of many entities that typically hedge larger quantities than provided for in the definition. The fact that futures contracts have a listing cycle of 24 months or more reflects this need.

Positions held by commercial participants, including producers, processors, merchants and other users, in contract months more than twelve months out generally are anticipatory hedges. The failure to recognize these positions as hedges would severely limit risk management programs for many commercial entities utilizing Exchange markets. The justification for the proposed restriction seems to be based on historical precedent, which is not particularly instructive given the evolution of markets and hedging practices in the decades following the initial adoption of the bona fide hedging definition. The Exchange therefore proposes that anticipatory hedging of more than twelve months of anticipated requirements or anticipated production be permitted.

The proposed rules on anticipatory hedging also fail to recognize the critical role merchants play in the cotton market. These entities provide liquidity and take on counterparty risk for producers, end-users and other commercial market participants. Merchants operating in international markets need to be able to manage the potential for defaults by counterparties. For example, a merchant may have a contract to buy cotton

from a producer located in a third world country. If the producer defaults, the merchant may need to manage that default by buying back the short hedge that had been established against the cotton he anticipated receiving and establish a long position to hedge the cotton he now needs to source.

The proposed definition of “bona fide hedging position” which will apply to all Referenced Products includes in the section on hedges of a physical commodity “assets which a person owns, produces, manufactures, processes, or merchandises or anticipates owning, producing, manufacturing, processing, or merchandising.” While this language clearly includes anticipated merchandising, comparable language is not included in the section defining “enumerated hedging positions”. As a consequence, a merchant cannot obtain an exemption for positions representing anticipated merchandising needs. The Exchange urges the Commission to expand the definition of enumerated hedging positions to recognize this activity which is significant to the cotton market. Such an expansion of the definition would create parity in the treatment of anticipated production/ownership and anticipated merchandising needs.

### Gross and Net Hedging

It is also important that commercial entities have the ability to manage their risks as market circumstances dictate. Under the longstanding rules of the Commission, market participants have the flexibility to determine whether to hedge risks on a gross or on a net basis. The proposed rules could place limitations on these decisions. Commercial entities have responsibility for the purchase and sale of cotton globally and use the Cotton No. 2 contract to manage risks for growths and qualities that often differ from Exchange qualities. The proposed rules could be interpreted to prevent the commercial sector from taking delivery simply because an entity owns physical cotton, without consideration of quality, growth, location or availability. In such cases the Cotton No. 2 contract could fail to provide proper risk mitigation, as illustrated by the examples below.

Example 1: Assume that a merchant has cotton inventory and forward purchase contracts from the United States, Brazil and India. The merchant makes the determination to hedge most of the United States cotton and a portion of the Brazil cotton because of the quality characteristics and the potential customers for the particular qualities of cotton being purchased. However, the merchant decides not to hedge any of the India cotton inventory and forward purchases because of current government programs in India affecting the local price and other factors, such as different potential customers for the quality and type of the specific India cotton being purchased. As market conditions change frequently, such as changes in government policy, the merchant needs to have the flexibility to modify its risk management strategy and decide if it should hedge all or just a portion of its inventory and forward purchase contracts, as determined by its risk managers.

The merchant also has outstanding sales to textile mills in Indonesia for the exact same quantity as its inventory and forward purchase contracts. These sales allow the merchant to deliver United States, Brazil or India cotton. The merchant

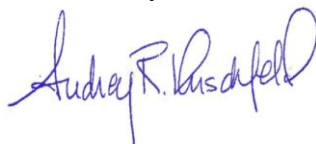
decides not to hedge these optional growth sales because its risk managers feel that this is the most economically appropriate decision. Under the proposed rules, the Commission may determine that the merchant's short hedges of its United States cotton inventory and forward purchases are not economically appropriate because the merchant's net cash position is zero. Under this scenario, since the cash positions are offset, the Commission could claim that the merchant's short hedges of its United States cotton increased the value exposure to the enterprise.

Example 2: Assume that a merchant has purchased cotton from cotton producers at \$0.60 per pound and after a subsequently large rise in cotton prices, sells the same amount of cotton to textile mill users at \$2.00 per pound. The price has been fixed for both transactions. Under the proposed rules, the Commission may determine that the merchant does not have the right to have short or long futures to protect against a large price change, and the risk of counterparty performance. The merchant has determined that contract performance and credit risk were the most economically appropriate risk to mitigate in this example, yet the Commission may not have allowed the merchant to manage this risk due to the Commission's narrow definition of risk as fixed price risk.

Because of the significance of the proposed rules to Exchange contracts, the Exchange consulted with the members of its Cotton Committee, which serves as an advisory body to the board of directors with respect to matters related to cotton. The members represent firms which are actively engaged in the trading of cotton, and many of the Committee members have co-signed the letter to emphasize the importance of the issues discussed to their businesses.

ICE Futures appreciates the opportunity to further comment on the proposed regulations and encourages the Commission to carefully consider the additional comments it receives before moving forward with any final rulemaking. Please do not hesitate to contact Susan Gallant at 212.748.4030, or the undersigned at 212.748.4083, if you have any questions or would like to discuss our comments in any respect.

Sincerely,



Audrey R. Hirschfeld  
Senior Vice President and General Counsel  
ICE Futures U.S., Inc.

cc: Stephen Sherrod  
Riva Spear Adriance

AS A CO-SIGNER TO THE ICE FUTURES U.S., INC. LETTER TO THE COMMODITY FUTURES TRADING  
COMMISSION RE: THE COTTON NO. 2 CONTRACT AND

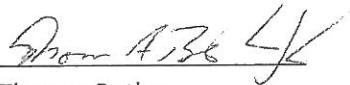
FEDERAL POSITION LIMITS AND AGGREGATION PROVISIONS



Phil Bogel

Toyo Cotton Co.

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Thomas Butler

Butler Brokerage

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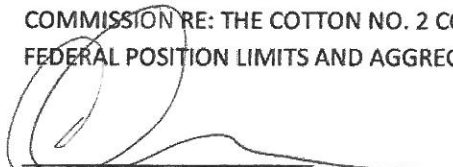
Ecom Trading

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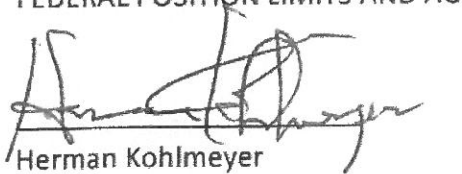
Stuart Frazer  
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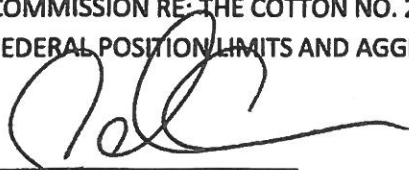
Colin Iles  
Glencore

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Herman Kohlmeyer  
Michael J. Nugent & Company, Inc.

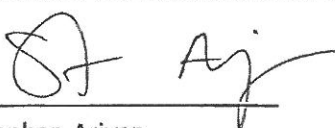
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Jordan Lea  
Eastern Trading Company

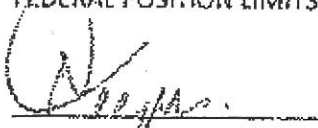
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Stephan Ariyan  
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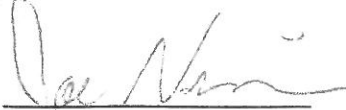


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Jarral Neepier  
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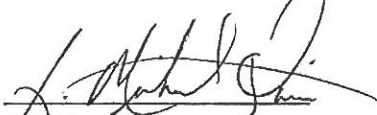


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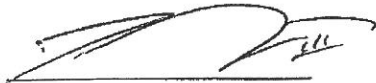
Joseph Nicosia  
Louis Dreyfus Commodities

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J. Michael Quinn  
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Parkdale Mills, Inc.

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Lonnie Winters  
Plains Cotton Cooperative Association