Atlanta Calgary Chicago Houston London New York Singapore

March 30, 2015

Via Electronic Submission

Mr. Christopher Kirkpatrick
Secretary
Commodity Futures Trading Commission
1155 21st Street, N.W.
Washington, D.C. 20581

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

Dear Mr. Kirkpatrick:

Intercontinental Exchange, Inc. ("ICE") appreciates the opportunity to provide comments and recommendations to the Commodity Futures Trading Commission's ("CFTC" or "Commission") in response to the Commission's re-opening of the comment period for its proposed rules establishing 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. Based on our review of the Proposed Rules, we respectfully request the Commission to reconsider several aspects of the Proposal in order to avoid significant harm to both markets and market participants. The Proposal, if adopted as a final rule, will result in negative disruption, via contractions in liquidity and increased volatility that will ultimately impose new costs on end-users, hedgers and consumers. In order to avoid that unnecessary result, we are submitting this letter to request that the Commission address the following issues. We encourage the Commission to take a reasoned approach to these issues and hope that the resulting structure will promote a well-functioning market that continues to allow participants to effectively manage risk. We specifically encourage the Commission to consider:

- Waiting to impose any new position limit regime until the Commission can adequately study whether the existing position limit structure is working;
- Setting the spot month limit for Core Referenced Futures Contracts ("CRFC") to 25% of the current estimate of deliverable supply;

IntercontinentalExchange
2100 RiverEdge Parkway
Suite 500
Atlanta, GA 30328
phone 770 857 4700
fax 770 951 1307
online www.theice.com

- Allowing higher position limits for financially settled contracts;
- Adopting single month and all-months combined position accountability levels instead of single and all months position limits and using existing tools--surveillance capabilities, special call authority, and oversight of Designated Contract Markets ("DCMs") and swap execution facilities ("SEFs")-- to address concerns related to speculative activity outside the spot month;
- Expanding the definition of bona fide hedging and the list of enumerated hedging transactions.

First, Do No Harm

The Proposed Rule differs considerably from the final rules issued by the Commission in 2011 and 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 expanded over the past 10 years. We have seen increased investment in energy production and transportation and as a result of this expansion there is increased participation in the energy markets. During this time of expansion, the natural gas markets have demonstrated stable pricing, model convergence and low volatility. The natural gas markets have seen nearly perfect convergence with an average price differential of less than a penny. The natural gas markets are in fact more efficient than other commodity markets and the open interest out the curve indicates a healthy and robust market. 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. Given the current market practices of commercial market participants and the robust and well-functioning markets currently in place, we strongly suggest that the Commission wait to see the impact of the existing position limit regime before implementing more changes.

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

Spot Month Limits Should Be Based upon Updated Estimates of Deliverable Supply

Commodity markets are global, and market participants transact in futures and swaps contracts in order to implement global risk management strategies. In its current form, the Commission proposes to adopt an expanded version of the DCM position limit regime and set position limits up to25% 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. The Commission proposes to base initial spot month limits on the levels currently in place at DCMs, but is considering alternative deliverable supply

estimates. ICE supports setting position limits at 25% of the most current estimate of deliverable supply and using alternative estimates for deliverable supply which reflect current market circumstances.[1] 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 participation in the energy markets have also increased. As such, 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.

Financially Settled Contracts Should Be Subject to Higher Spot Month Position Limits

Financially settled contracts are not the economic equivalent of physically settled contracts and should not be subject to the same position limits. Cash- settled contracts transfer price risk as the vast majority of market participants do not want the risk of physical settlement, evident in the substantial decrease in physical delivery spot month open interest during the weeks leading up to first notice day, but they want exposure to the final settlement price. Imposing equal limits on both contract types presupposes that the contracts are fungible, which they are not. Rather, physically settled contracts are a liquidity tool for the physical commodity being traded, whereas financially settled contracts serve as a method for legitimate hedging and do not impact the underlying price of the asset. The price correlation between financially and physically settled contracts is due to the fact that financially settled contracts follow, or are priced based on, the price of physically settled contracts. In addition, cash-settled contracts are less susceptible to manipulation.[2] 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 supply. Historically, a 25% spot month limit was 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. The contracts today and the Conditional Limit recognize these differences. Market participants access each contract for a distinct reason. Imposing equal levels for each contract type may result in

[1] 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.
[2] *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.

unnecessarily constraining legitimate risk management activity in the spot month and would not contribute to or advance the CEA goal of deterring and preventing price manipulation or any other disruptions to the market.

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 has no ability to influence the final settlement price of the corresponding physically-delivered contract, and Dodd-Frank changes have pushed 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 hold a position up to 5 times the limit applicable to the physically-settled natural gas contract if the participant does not hold a position in the physically settled contract. In the Commission's 2011 position limit rule, the Commission codified and recognized the need for and benefits of the Conditional Limit. The Proposed Rule now pending before the Commission reaffirms this policy and recognizes 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.

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[3]. 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. As the past four years have shown, the Conditional Limit avoids unnecessarily limiting liquidity and price discovery in contracts with less potential to impact the physical contract settlement and has the beneficial effect of incenting 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.

[3] http://www.ers.usda.gov/media/1252331/fds-13l-01.pdf

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 Proposed Rules needs 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.[4] 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.[5] 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.

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. 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 may be 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 the market, sapping valuable liquidity from commercial market users and their ability to hedge long dated risk. Hard position limits in the spot month of a contract and position accountability levels in the remainder of the contract would encourage speculative participants to assume risk in

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[4] 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.

[5] 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.

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 demonstrate that position limits will have a positive impact outside the spot month. The risk of abusive speculation or manipulation outside the spot month is highly limited. The discipline of delivery, whereby market participants holding long and short positions must be prepared to take or make delivery, respectively, does not apply other than in the spot market. As a result, trading outside the spot month does not cause corners, squeezes or other congestion that is of concern for market manipulation and other abuses. Recognizing a similar principal, the Commission's recently adopted disruptive trading rules, adopted pursuant to statutory authority added in Dodd-Frank, specifically focus on congestion in the closing period (and not other times in the life of the contract).[6] Therefore, instead of non-spot month position limits, the Commission should focus on (i) enhancing the quality of swaps data it receives and (ii) continuing to develop its understanding of the changes in market structure that have occurred since the implementation of the Dodd-Frank swaps rulemaking programs. In addition, the Commission should consider measures that will enhance the utility of its existing tools-surveillance capabilities, special call authority, and oversight authority of DCMs and SEF's- to address concerns related to speculative activity outside the spot month.

The Commission should also note that setting aggregate hard position limits across contract months and trading venues adopts the current position limit regime for legacy agricultural markets, such as cotton. 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.

[6] *See* Antidisruptive Trading Practices Authority, 78 Fed Reg. 31890 (May 28, 2013).

As noted above, the Commission could proscribe aggregate hard limits in the spot month, where price discovery principally occurs and allow position accountability levels for single months and all months combined. 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]

Statutory Authority to Adopt Position Accountability Levels Outside the Spot Month

The Commission has the statutory authority to adopt position accountability levels outside of the spot month pursuant to CEA Section 4a(a)(1)-(3). ICE understands that the Commission has concerns about whether it has the discretion to adopt accountability levels rather than hard limits outside of the spot month. ICE respectfully submits that several provisions in CEA Section 4a(a) authorize the CFTC to implement accountability levels. First, First, as discussed in a comment letter on the proposed position limit rules submitted by the Futures Industry Association dated February 7, 2014 ("FIA PL Letter"), the Commission can and should determine that under Section 4a(a)(1) hard limits outside the spot month are not necessary to prevent excessive speculation.[8] Second, Section 4a(a)(3) of the CEA authorizes the Commission to set limits "as appropriate." This provision provides the Commission with discretion to determine whether and, if so, what types of limits are appropriate. Accountability levels, which operate as flexible limits because the Commission can order a market participant who exceeds a particular level to reduce its position, are more appropriate than hard limits outside the spot month because of their more limited impact on market liquidity and price discovery. Third, CEA Section 4a(a)(7) provides the Commission with broad discretion to exempt, "conditionally or unconditionally," any swap or futures contract from any position limits requirement. Thus, in addition to subsections (a)(1) and (a)(3), this Section similarly enables the Commission to adopt accountability levels rather than hard limits outside the spot month. [9]

Spot Month Accountability Levels Should be Maintained for the Henry Hub Penultimate Options and Futures Contracts

Penultimate options serve as price protection for commercial market participants so they can secure the economic equivalent of a futures contract. Penultimate futures serve as a risk mitigation strategy against the penultimate option position; they do not trade independently. Both contracts expire one business day prior the expiration of the Henry Hub LD1 CRFC. Currently, penultimate options and futures have spot month accountability levels while both the Henry Hub LD1 physical delivery and cash-settled contract have spot month limits. The Proposed Rules

[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.

[8] ICE supports the testimony of William McCoy, representing FIA, at the EEMAC meeting on February 26, 2015 discussing the Commission's ability to adopt accountability levels outside of the spot month.

[9] ICE supports the testimony of William McCoy, representing FIA, at the EEMAC meeting on February 26, 2015 discussing the Commission's ability to adopt accountability levels outside of the spot month.

aggregate Henry Hub penultimate options and futures with positions in the CRFC thus subjecting penultimate futures and options to hard spot month position limits. ICE strongly recommends that the Commission continue to allow exchanges to impose spot month accountability levels which expire during the period when spot month limits for the Henry Hub CRFC are in effect. Natural gas is the only commodity where options, and the corresponding future they exercise into, expire during the spot month period for the underlying futures contract. As such, the Commission must recognize these nuances and accordingly impose accountability levels in the spot month. The Commission has no reason to believe that market participants will arbitrage these contracts in the spot month as the penultimate contracts currently trade side-by-side with the Henry Hub LD1 futures and there has been no evidence of a migration to the penultimate contracts due an accountability limit versus a hard spot month limit. In addition, prices in the penultimate future have no ability to impact to the settlement of the CRFC.

Exchanges' and Market Participants' Reliance on Good Faith Exemptions

The Proposed Rules would broadly transform the role of the Commission in the daily administration of position limits and the granting of hedge exemptions, from an oversight role to direct regulation of markets over which exchanges currently exercise such authority. Given the significant time and resources that such an undertaking would require and the time sensitive nature of exemption requests, we believe that the current structure—whereby the Commission oversees certain domestic agricultural commodities while the listing exchanges oversee their other products—reflects an efficient allocation of responsibility and resources that ensures commercial market participants will be able to continue to hedge their risks in a timely manner. We believe that our contracts currently work well, both from the perspective of commercial market participants and exchange regulators, and that the current regulatory regime for these products-- which is overseen by the CFTC and incorporates rules subject to CFTC review--, should remain in effect. Accordingly, the exchanges should continue to exercise the authority to grant non-enumerated hedge exemption requests pursuant to their rules and procedures.

Further, the Commission should expressly confirm that neither the exchange, nor a market participant that relies in good faith on an exemption granted by an exchange, would be subject to enforcement action in the event the Commission later disagreed with the exchange determination.[10] In other words, the Commission's views would be relevant to future determinations by the exchange but would not be retroactively applicable to positions already established pursuant to the exemption. By providing this certainty to the market, the Commission would be acting consistent with Regulation 38.6 which provides that:

[10] Fraud or other misconduct in connection with obtaining an exemption would not be subject to protection from prosecution as the market participant would be unable to demonstrate good faith reliance on the exchange determination.

> "An agreement, contract or transaction entered into on or pursuant to the rules of a designated contract market shall not be void, voidable, subject to rescission or otherwise invalidated or rendered unenforceable as a result of
>
> > (a) violation by the designated contract market of the provisions of section 5 of the Act or this part 38; or
> >
> > (b) Any Commission proceeding ….. the effect of which is to alter, supplement, or require a designated contract market to adopt a specific term or condition, trading rule or procedure, or to take or refrain from taking a specific action."

The Commission Should Expand the Bona Fide Hedge Definition and Enumerated Hedging Exemptions

The Commission has limited the definition of a 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 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, which can be a considerable concern in energy markets. The restrictive bona fide hedge definition and limited exemption list will constrain the ability of firms to use the derivatives markets to hedge and will impede the price discovery process on derivatives exchanges. ICE supports the Commercial Energy Working Group petition for relief for certain bona fide hedging transactions[11] and the specific examples referring to merchandising and anticipatory merchandising transactions, unfilled and unfixed anticipated requirements and unsold and unfixed priced anticipatory requirements, cross commodity hedging and calendar month averaging cited in their comment letters[12] and testimony at the EEMAC meeting on February 25, 2015. 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.

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[11] See The Working Group of Commercial Energy Firms, Petition for Commission Order Granting Exemptive Relief for Certain Bona Fide Hedging Transactions Under Section 4a(a)(7) of the Commodity Exchange Act (submitted Jan. 20, 2012), available at http://www.cftc.gov/stellent/groups/public/@rulesandproducts/documents/ifdocs/wgbfhpetition012012.pdf. ("BFH Petition"). In February 2012, the Working Group of Commercial Energy Firms reconstituted itself as "The Commercial Energy Working Group."

[12] See The Commercial Energy Working Group, Comment Letter Re: Position Limits for Derivatives, RIN 3038-AD99 (Feb. 10, 2014) ("Working Group Feb. 10th Letter") and the Commercial Energy Working Group, Comment Letter Re: Position Limits for Derivatives, RIN 3038-AD99 (August 4, 2014).

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