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September 28, 2016

**Via Electronic Submission**

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

**Re:** ***Federal and Exchange Set Spot Month Limits***

Dear Mr. Kirkpatrick:

Intercontinental Exchange Inc. ("ICE") is submitting comments and recommendations to the Commodity Futures Trading Commission ("CFTC" or "Commission") for consideration regarding its final position limits rulemaking[1]. ICE supports the Commission's commitment to ensuring well-functioning, efficient markets, including the implementation of reasonable speculative position limits. Markets can function well where speculative position limits are appropriately set. To accomplish this, speculative position limits and their subsequent administration must: (1) be transparent, efficient and principled; (2) provide flexibility to allow for the development and use of hedging practices; and (3) be established in a way to reflect underlying market conditions. Inadequacy in these areas risks damaging the market response to changes in underlying fundamentals, discouraging risk management practices, reducing liquidity, and increasing the cost of hedging.

The Proposed Rule would establish spot month position limits based upon an estimate of 25 percent of deliverable supply for the commodity in each core referenced futures contract ("CRFC").[2] Initially, the Commission would adopt the existing spot month speculative position limits set by individual designated contract markets ("DCM"). However, as an alternative, the Commission is considering setting the initial spot month limits at levels based on estimates of deliverable supply submitted by the exchanges. ICE recommends the Commission set federal spot month position limits at 25% of deliverable supply for physically delivered contacts. The Commission must base these spot month limits however upon a reasonable and current estimate of deliverable supply. Therefore, the CFTC should continue to rely on the DCMs to estimate deliverable supply for purposes of adopting spot month speculative position limits. Historically, the Commission has deferred to the exchanges' experience, expertise and access to reliable data

[1] *See Position Limits for Derivatives*, 78 Fed. Reg. 75680 (Dec. 12, 2013) ("Proposed Rule").

[2] Proposed Rule at 150.2(a).

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

for estimating the level of deliverable supply. The Commission should validate and rely upon the exchanges' alternative estimates and should rely on the most current levels of estimated deliverable supply available. Any limits based on inaccurate estimates or set at levels less than 25% of deliverable supply would be overly restrictive and may limit the liquidity available to bona fide hedgers. The lack of liquidity will in turn impede price discovery in the spot month. This is especially important considering that the spot month limit will now apply to the combined position held across DCMs and in equivalent bilateral swaps.

ICE further recommends that the Commission establish spot month position limits for cash-settled contracts at levels higher than the physically-delivered contracts because cash-settled contracts are less susceptible to manipulation.[3] Spot month limits are designed primarily to reduce the ability of a trader to manipulate the price of the contract or underlying commodity. For physically-settled contracts, spot month limits are designed to reduce the potential for corners and squeezes as the physically-delivered contract approaches expiration, rather than address any incentives for manipulation that may exist due to positions in the cash market. Historically, for cash settled contracts, where there is no possibility of corners or squeezes, neither the level of the deliverable supply nor the amount of positions in the cash market have been a relevant factor in setting the spot month limit. Rather, exchanges have been required to set the level as necessary to "minimize the potential for manipulation or distortion of the contract's or the underlying commodity's price." As the Commission has recognized, a cash-settled contract presents a reduced potential for manipulation of the price of the physically-settled contract, and therefore a higher spot month limit is appropriate.

In related fashion, the conditional spot month limit for cash-settled contracts must be maintained at no less than the current levels. The CFTC, 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 in the OTC markets into exchanges and clearinghouses, imposed a conditional limit in February 2010 on cash settled contracts in the natural gas market. In the 2011 and 2013 position limit rulemakings, the Commission again recognized the differences between cash-settled and physically-settled contracts and codified the five-time conditional limit. In the six years since the conditional limit has been in place, the market has seen improved hedging between cash-settled and physically settled contracts, curbed market volatility and stable gas prices.

As such, the Commission has no basis to modify the current conditional limit level. The markets have functioned efficiently and effectively. Why should the Commission change the status quo? In fact, the conditional limit of five times the spot month limit appears to be arbitrary and likely insufficient. The Commission provides no indication as to how it arrived at this figure or that it strikes the right balance between supporting liquidity and diminishing undue burdens.

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[3] *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.

As previously noted[4], empirical data since February 2010, has shown that trading in the NYMEX physically settled contract has substantially increased over the past six years. Since the conditional limit has been in effect, the NYMEX physically-delivered Natural Gas average monthly volume and open interest have increased. Volume in the spot month contract has also increased each year since 2009, before the Conditional Limit was implemented. Taken into consideration with the potentially low deliverable supply calculations, the conditional limit could have an even less cushioning effect for contracts and markets that historically have seen greater activity during this period. We respectfully suggest that the Commission consider the dynamics of individual spot month markets before making a limit determination and ensure that the calculations are responsive and not overly rigid.

Furthermore, the Commission should adopt accountability levels in lieu of single-month, hard speculative position limits. The Commission has the statutory authority under various provisions of the CEA to implement and administer a position accountability regime. The purpose of a position limits regime is to diminish, eliminate, or prevent "excessive speculation." ICE has previously commented on and explained during an EEMAC meeting[5] that its non-spot month accountability regime has a proven track record of successfully deterring excessive speculation and manipulation. Because liquidity tends to decrease farther out the curve, DCMs have employed accountability regimes to monitor positions in deferred months, which serves to preserve liquidity for bona fide hedgers, protect the price discovery function of the derivatives markets, and also restrict speculative activity where the DCM identifies the potential for excessive speculation based on a dynamic review of a trader's position. In contrast, hard limits outside of the spot month restrict all positions that do not qualify as bona fide hedging positions, including legitimate and non-speculative activity such as risk management positions.

Finally, spot month accountability levels should be maintained for the Henry Hub penultimate options and futures contracts. Both contracts expire one business day prior the expiration of the Henry Hub LD1 CRFC and as such 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 a result of this nuance, penultimate options and futures historically have spot month accountability levels instead of spot month limits. The Proposed Rule aggregates 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. 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

[4] See ICE's Response to CME's Comment Letter Dated July 13, 2016.

[5] During a February 25, 2015 EEMAC meeting Erik Haas and Tom LaSala discussed the current exchange accountability levels and process.

penultimate contracts due to an accountability level versus a hard spot month limit in the CRFC. In addition, prices in the penultimate future have no ability to impact the settlement of the CRFC.

ICE appreciates the Commission thoroughly reviewing our recommendations and comments as the Commission develops its final position limit rulemaking. ICE encourages the Commission to be cognizant when it exercises its regulatory oversight authority of the effect of the proposed federal limits on the ability of derivatives markets to perform their fundamental price discovery, risk transfer, and risk management functions, which depend on the existence of liquid, fair, and competitive markets. Any proposal that could compromise these functions must be carefully scrutinized.

Sincerely,

Kara Dutta
Intercontinental Exchange, Inc.

cc: Honorable Timothy G. Massad, Chairman
Honorable Sharon Bowen, Commissioner
Honorable J. Christopher Giancarlo, Commissioner
Vincent A. McGonagle, Director
Stephen Sherrod, Senior Economist
Riva Spear Adriance, Senior Special Counsel
Lee Ann Duffy, Assistant General Counsel
Steven Benton, Economist