Atlanta Calgary Chicago Houston London New York Singapore

February 28, 2017

Via Electronic Submission

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

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

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 reproposed position limits rulemaking[1] ("Reproposal or Reproposed Rule"). ICE applauds the Commission for allowing an additional opportunity for the Acting Chairman, new Commissioners, CFTC Staff and market participants to take a fresh look at the important issues raised by position limits. As the position limit rule is complicated, lengthy and has undergone multiple iterations over the course of six-plus years, ICE supports and agrees with the Commission's decision to re-propose the rule. ICE additionally supports the Commission's commitment to ensuring well-functioning, efficient markets. Markets can and have functioned efficiently when position limits are set appropriately and calculated using accurate and current data. Position limits have and must continue to: (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 unique, underlying market conditions.

Given the complexity of this rulemaking and potential long-term implications, ICE urges the Commission to review the comments submitted in this proceeding along with market data to determine whether federal position limits are necessary for exempt commodities. The Commission should revisit and adequately justify that such limits are necessary for each individual physical commodity market in which it proposes to establish such limits. Congress included in the Commodity Exchange Act ("CEA") amendments a requirement that the Commission find that position limits are "necessary" and "appropriate" before imposing them and directed the Commission to establish limits on "the amounts of trading which may be done or the positions which may be held by any person" as the Commission finds are "necessary to

[1] *See Reproposed Position Limits for Derivatives*, 81 Fed. Reg. 96704-96990 (Dec. 30 2016) ("Reproposed Rule").

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

diminish, eliminate or prevent" an undue burden on interstate commerce. Congress recognized that restrictive limits would impede market liquidity and price discovery. When the Commission exercises its regulatory oversight authority, it must be cognizant 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 all depend on the existence of liquid, fair, and competitive markets.

Furthermore, the Commission should identify and carefully examine the problem it is attempting to solve. Legislative efforts to regulate the derivatives markets following the 2007 financial crisis were aimed at imposing trading requirements and position limits on all U.S. commodity exchanges. Congress promoted transparency by determining that all electronic energy markets should have regulatory oversight by the CFTC. In 2009, as a guiding force of policy reform, the U.S. House of Representatives Committee on Agriculture, approved the "Derivatives Trading Transparency and Accountability Act of 2009," which proposed to further regulate swaps, set commodity specific speculative position limits for all U.S. commodity exchanges and require that all contracts be traded on exchanges and reported to the CFTC. The goals of this legislation have since been accomplished: all U.S. electronic energy exchanges are now DCMs regulated by the CFTC and **as of October 2012, all U.S. energy contracts have position limits**.

As the aforementioned legislative goals have been met and markets have functioned efficiently, the Commission should not replace the current well-functioning position limit regime with new, overly complicated and restrictive rules. While the Reproposal is an improvement over the previous proposals, it still contains problematic provisions which could cause harm to market participants and disrupt well-functioning markets. Instead of moving forward with the Reproposal, the Commission could consider maintaining the current exchange-set position limit regime with respect to non-enumerated commodities which focuses on spot month limits and accountability levels for non-spot months. If the Commission, after a further necessity finding, determines to move forward with implementing a position limit rulemaking, the Commission could adopt the current position limit regime at U.S exchanges for non-enumerated contracts whereby DCMs set and administer their own position limits with continued CFTC oversight, while maintaining current federal limits for enumerated products. Under this scenario, the U.S. futures markets, governed by the Commission's comprehensive-but-flexible regulatory structure, would permit and promote commercial and professional market participants to continue hedging future price risk in an efficient and cost-effective manner. Adopting the current position limit regime, instead of the Reproposal, would strike the right balance between the prescribed statutory goals related to deterring excessive speculation and market manipulation while ensuring sufficient market liquidity and price discovery for bona fide hedgers. The exchanges would be allowed to continue granting appropriate hedge exemptions under the current rules and

market participants would continue to rely on proven, long-standing hedging practices and strategies.[2]

If, however, the Commission does decide to move forward with the Reproposed Rule, ICE reiterates its previous comments[3] and strongly urges the Commission to adopt the following changes to the CFTC's Reproposal prior to completing any final position limit rule:

- Allowing higher position limits for financially settled contracts, as exists today for the well-functioning Henry Hub natural gas contract;
- Adopting single month and all-months combined position accountability levels instead of single and all months position limits;
- Expanding the definition of bona fide hedging and the list of enumerated hedging transactions;
- Subjecting penultimate natural gas options to accountability position limits only, as is the case on futures exchanges today.

These critical changes would bring the rule closer to our rules today and preserve appropriate and tested risk management practices employed by commercial market participants. ICE appreciates the Commission thoroughly reviewing our recommendations and comments as it considers the position limit rulemaking. As the Commission progresses with this evaluation, we encourage you to be cognizant of the impact that federal limits may have on the ability of derivatives markets to perform their fundamental price discovery, risk transfer, and risk management functions.

Sincerely,

Kara Dutta
Assistant General Counsel
Intercontinental Exchange, Inc.

[2] Please also refer to the comment letter dated February 28, 2017 from ICE Futures U.S. which discusses additional modifications to the Reproposal.

[3] Attached as Annex A is a compilation of all of the previously submitted ICE comment letters.

cc: Honorable J. Christopher Giancarlo, Acting Chairman
Honorable Sharon Bowen, Commissioner
Amir Zaidi, Director
Stephen Sherrod, Senior Economist
Riva Spear Adriance, Senior Special Counsel
Lee Ann Duffy, Assistant General Counsel
Steven Benton, Economist

<u>ANNEX A</u>

TABLE OF CONTENTS OF PREVIOUSLY SUBMITTED ICE COMMENT LETTERS

1) September 28, 2016
2) March 30, 2015
3) August 4, 2014
4) February 10, 2013
5) January 17, 2012
6) March 28, 2011

Atlanta Calgary Chicago Houston London New York Singapore

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.

[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

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

---

[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.

---

[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

Atlanta Calgary Chicago Houston London New York Singapore

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.

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

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

Atlanta Calgary Chicago Houston London New York Singapore

February 10, 2013

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:

IntercontinentalExchange, 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;
- Removing Trade Options from the definition of physical-delivery Referenced Contract and exempt Trade Options from the Proposed Rules;
- Permitting market participants to make commercially reasonable determinations of which contracts are substantially related for the cross-commodity hedge exemption;
- Interpreting the orderly trading requirement consistently with the disruptive trading practices rule; and
- Keeping arbitrage and spread exemptions.

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

Policies Underpinning the Proposed Limits

The proposed limits differ considerably from the final rules issued by the Commission in 2011 and as detailed below 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 changed. Following high energy prices in 2007 and 2008 we have seen increased investment in energy production and transportation. For example, in 2012, for the first time since 1949, the U.S. was a net exporter of oil.[1] Given this fact, 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."[2]

Furthermore, by including the CEA requirement that the Commission must find position limits are "necessary" and "appropriate" before imposing them, Congress recognized that restrictive limits would impede market liquidity and price discovery. When the Commission exercises its regulatory oversight authority, it must be cognizant 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. Therefore, any proposal that would tend to adversely affect the liquidity, fairness or competitiveness of the futures markets must be carefully scrutinized.

[1] http://www.bloomberg.com/news/2012-02-29/u-s-was-net-oil-product-exporter-in-2011.html

[2] 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).

In its proposed rules, the Commission has recommended significant changes to the position limit regime for derivatives. Protecting the integrity of the derivatives markets from excessive speculation is a laudable goal, but it is important to note that the Commission has neither demonstrated nor determined that excessive speculation exists in the derivatives markets. New section 4a(a)(3) of the CEA qualifies the CFTC's authority by directing it to set such position limits, "as appropriate. . . [and] to the maximum extent practicable, in its discretion: (i) to diminish, eliminate, or prevent excessive speculation." This requires factual support for position limits based on preventing excessive speculation or deterring market manipulation balanced against the impact on market liquidity and price discovery. The Commission has not provided or sighted such factual support or evidence that speculation causes changes in commodity prices. It is vitally important that the Commission take action that reasonably addresses these issues. Tying position limits to excessive speculation, especially without a finding of excessive speculation, could lead the Commission to play the role of price authority.

ICE believes that position limits should be set to prevent manipulation around contract expiry and delivery and to prevent delivery disruptions, and not with a goal to influence commodity price levels. In determining position limits, the Commission should consider the entire size of the relevant markets – both exchange-traded and OTC and both domestic and domestically linked. This is very important because the proposed rule may set position limits before the mandatory trading and clearing provisions of Dodd-Frank are fully in effect. Thus, the proposed rules will come at a time of significant change in derivatives markets as market participants will be bringing business traditionally conducted bilaterally onto exchanges. By implementing an onerous position limit regime and limiting all financial and physically delivered contracts to deliverable supply, the Commission may inadvertently restrict the ability of market participants to put positions onto exchanges and clearing houses at the same time that Congress is requiring more, or all, positions be cleared and exchange traded.

Further, the Commission should set position limits not based upon current activity alone, but to permit growing participation in the derivatives markets. The 2011 position limits rule and the proposed rule are based on extremely limited market data. The Proposed Rule only considers open interest during calendar years 2011 to 2012 for futures contracts, options on futures contracts, and significant price discovery contracts that are traded on exempt commercial markets. It ignores the volume of OTC transactions in Referenced Contracts for which the Commission has collected detailed information.[3] The Commission also declined to rely on open interest data from the Part 20 swaps large-trader reporting data and swap data reported to swap data repositories ("SDRs") in accordance with Parts 43, 45, and 46 of the Commission's rules. Failing to accurately assess market size and thus, liquidity needs, in setting position limits, accountability levels and appropriate exemptions will likely result in artificially low limits and create barriers to a well-functioning, centrally cleared, regulated and competitive derivatives market in the United States.

---

[3] *See* Proposed Rule at 75730.

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

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 CFTC properly setting and administering single and all month spot 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. A June 2007 report published by the U.S. Senate Permanent Subcommittee on Investigations entitled, "Excessive Speculation in the Natural Gas Market," focused on natural gas trading by the hedge fund, Amaranth Advisors, in both the NYMEX physical futures market and the ICE swaps market. The report is replete with analysis supporting the conclusion that these two markets, one physically settled and the other cash settled, were and are "functionally equivalent" and "provide economically identical hedging and risk management functions."[4] 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. Furthermore, Congress, in its financial reform efforts, 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 further recommends the Commission continue to gather additional data regarding the OTC swaps

[4] *"The data analyzed by the Subcommittee, together with trader interviews, show that NYMEX and ICE are functionally equivalent markets. Natural gas traders use both markets; employing coordinated trading strategies…The data show that prices on one exchange affect the prices on the other."* ("Excessive Speculation in the Natural Gas Market", U.S. Senate Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, Sen. Carl Levin, Chairman, June 25, 2007, p. 3.)
"The ICE natural gas swap and the NYMEX natural gas futures contract perform the same economic functions." (Ibid, p. 29).
"In sum, the structure of the ICE swaps and NYMEX futures contracts, the virtually identical prices of these two contracts, and the testimony of traders provide compelling evidence that the NYMEX natural gas futures contract and the corresponding ICE natural gas Henry Hub swap are economically indistinguishable financial instruments for risk-management purposes." (Ibid, p. 36).

markets so that the Commission can make a more informed decision regarding position limits in the future. Given that the CFTC has limited data on the OTC swaps market for the 28 referenced commodities, especially due to the high percentage of end-user to end-user OTC swap transactions coupled with an end-user effective reporting date of August 19, 2013, we believe that it would be premature for the Commission to impose restrictive spot-month limits. 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.

ICE further recommends that the Commission establish spot position limits for cash-settled contracts at levels higher than the physically-delivered contracts because cash-settled contracts are less susceptible to manipulation.[5] While ICE agrees that deliverable supply is the appropriate basis for setting limits on physically settled-contracts, which involve the making and taking of delivery and impact a commodity's settlement price, we do not believe the same is true for cash-settled contracts. 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. As such, the prices of cash-settled spot-month contracts can fluctuate and converge to the price of the physical commodity as settlement approaches. By contrast, it is possible that limitations on transportation and on available supply of an underlying physical commodity can lead to price distortions and opportunities for price manipulation in spot month contracts that must be satisfied by physical delivery. For these reasons, it is appropriate for the Commission to set limits higher for cash settled contracts in the spot month.

Finally, in its spot month position limit regime, the Commission has proposed a new definition of spot month. In particular, for average price contracts, the Commission proposes to expand the spot month to the entire period for calculation of the settlement price. Thus, for a monthly average price contract, the spot month would be the entire month rather than the current exchange practice of the final three days (or week) before final settlement. The Commission has

[5] *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.

always encouraged the development of average price contracts given that these contracts do not have a discrete settlement period that can be susceptible to manipulation. Expanding the spot month position limits on these contracts would only serve to discourage creation and participation of average price contracts. The Commission should adopt current exchange practices and employ a spot month that covers the final three days or week before settlement.

Conditional Spot Month Limit for Financially Settled Contracts

Since February 2010, the CFTC has provided for a "Conditional Limit" for financially settled natural gas contracts during the last three days of contract trading. Under the Conditional Limit, a market participant may carry a position in the financially-settled natural gas contracts (ICE H or CMENN) that is up to 5 times that of the physically-settled natural gas contract's (CMENG) position limit if the participant agrees not to hold a position in the NG contract in the last three days. 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 provision went into effect, natural gas prices have been lower and less volatile than historical levels. ICE has received no complaints regarding natural gas markets during that timeframe nor are we aware of any complaints received by CME or the CFTC. Liquidity in the physically-settled CME NG contract has also increased.

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. Furthermore, eliminating or decreasing the Conditional Limit for cash-settled contracts would 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 designated contract markets ("DCM"), swap execution facilities ("SEF"), and the bilateral OTC market. 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.

Moreover, ICE urges the Commission to appropriately recognize the vastly different expiry behavior of physical versus cash-settled contracts and, in doing so, remove or, at least, further liberalize the last three day position limit methodology for cash-settled contracts. By ordering a last three day position limit methodology for the ICE Henry Hub natural gas contract

that was materially different from the CME natural gas futures contract, the Commission had already correctly concluded that physically delivered contracts and their cash-settled lookalikes behave very differently at expiration and therefore require different expiration position limits. Therefore, a higher limit for cash-settled contracts makes sense. 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.

Finally, under Part 19 of the proposed rules, a market participant that relies on the Conditional Limit must file a Form 504 daily with the Commission. The daily statements relate to cash commodity positions and are broader than the category of cash-market positions eligible for *bona fide* hedge positions. As a result, reporting systems now need to identify a broader class of cash market activity for Form 504 compared to cash market activity to be reported on Form 204. This proposed daily reporting requirement imposes significant burdens and substantial costs on market participants and requires the development of additional systems to identify all cash-market positions as opposed to cash-market positions eligible for the *bona fide* hedge exemption. ICE recommends that participants relying on the Conditional Limit should be permitted to file monthly *bona fide* hedging reports, rather than a daily filing of all cash market positions consistent with current exchange practices.

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.[6]

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 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

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

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 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.[7]

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

[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.

supply estimates. ICE supports using alternative estimates for deliverable supply which update deliverable supply to reflect current market circumstances.[8] ICE believes that 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, as position limits will aggregate across trading venues, and will apply to uncleared OTC swap contracts. As such, ICE urges the Commission to adopt revised deliverable supply estimates which reflect current market conditions.

Bona Fide Hedge Exemptions

The Commodity Exchange Act states that, "[n]o, rule, regulation, or order issued under subsection (a) of this section shall apply to transactions or positions which are shown to be *bona fide* hedging transactions or positions . . . Dodd-Frank directs the Commission to define a *bona fide* hedge exemption as off sets of cash market transactions." This new definition of a *bona fide* hedging transaction is far more limited than Commission regulation § 1.3(z)(1) and narrower than the definition proposed in the 2011 position limit rule. In addition, the Commission has narrowed the bona fide hedging exemption to a list of enumerated bona fide hedging transactions instead of all physical commodity price risk-reducing transactions entered into by commercial market participants. The current position limit proposal does not recognize non-enumerated hedges as bona fide and only allows market participants to receive position limit exemptions for non-enumerated hedge positions if the Commission grants an ad hoc request for an exemption. This restrictive definition and limited bona fide hedge exemption list will constrain the ability of firms to use the derivatives markets to hedge. Moreover, the Commission has eliminated the spread and arbitrage exemptions which will impede the price discovery process on derivatives exchanges. The proposed orderly trading requirement will also constrain market participants' ability to unwind and exit positions.

In general, the proposal extends the program for granting *bona fide* hedges that currently exists for the enumerated agricultural commodities to energy contracts. However, the proposed rules do not recognize that commercial market practices in these markets differ from those in the enumerated agricultural products and that, consequently, merely extending the current Commission program to these commodities will create a flawed system. 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. In particular, we are concerned that the proposed rules could needlessly prevent such participants from fully managing their commercial risk through futures and options that are cleared through entities regulated by the Commission.

[8] 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.

For instance, the Commission narrowed the bona fide hedging exemption to a list of enumerated bona fide hedging transactions. This is a departure from the 2011 position limit rule which did not categorically exclude non-enumerated hedging transactions from receiving bona fide hedging treatment. [9] The new proposal similarly does not recognize non-enumerated hedges as bona fide and would allow market participants to receive position limit exemptions for non-enumerated hedge positions only if the Commission grants an ad hoc request for an exemption. ICE recommends the Commission utilize the enumerated hedge exemptions as examples of a sub-set of the range of transactions that qualify as bona fide hedging transactions and to not categorically exclude non-enumerated hedging transactions from receiving bona fide hedging treatment. In addition, the proposed procedures for applying for and granting exemptions of non-enumerated hedge exemptions are complex, vague and will create uncertainty for market participants as to when and whether their hedging strategies will qualify as a bona fide hedge. Market participants can petition the CFTC, pursuant to CEA section 4a(a)(7), to issue a rule, regulation or order, to expand the list of enumerated positions to include the position described in the petition.[10] However, in contrast to the Commission's existing procedures for granting non-enumerated hedge exemptions, the exemption process in the Proposed Rule does not specify a timeframe within which the Commission must address a request. Currently, under CFTC Rule 1.47, the CFTC Staff have 30 days to respond to a new request for a non-enumerated hedge position or 10 days to respond to an amendment to an existing request. ICE recommends that the Commission continue to authorize non-enumerated hedging transactions through mechanisms like the ones in existing CFTC Rules 1.3(z)(3) and 1.47.

Moreover, the proposal eliminates the spread and arbitrage exemptions that are currently recognized by exchanges. In ICE's energy contracts, the spread and arbitrage exemptions are vitally important to the functioning of the markets because they allow participants to hedge risk assumed through the normal course of business. ICE uses the spread exemption to allow traders to spread positions between the Henry Hub natural gas contract and natural gas basis points. Hedging basis risk allows a trader to hedge the cost of delivering natural gas to any particular point in the country. Given that the Commission is not aggregating basis contracts as referenced energy contracts, a spread exemption for these transactions is vitally necessary to allow traders to hedge basis risk in natural gas.

The arbitrage exemption is also critical to the energy markets by allowing, as the Commission recognizes, the arbitrage of economically equivalent contracts to create one market. Arbitraging ensures that if one market does not reflect fundamentals, it will eventually be brought back into line with other markets, which greatly decreases the risk of a market being manipulated over the long term. In addition, the open access provisions of Dodd-Frank encourage the listing of economically equivalent swaps by SEFs. Without arbitraging, prices of

---

[9] *See* 17 CFR 1.3(z)(3).

[10] Proposed Rule at 75718. The Proposed Rule also provides that market participants can file a request for an interpretation from Commission Staff under CFTC Rule 140.99 regarding whether a hedging position falls within the existing list of enumerated hedging positions. *See id.* at 75717.

equivalent swaps on these SEFs could begin to diverge, and could ultimately create misleading settlement prices, which in turn could present greater risk to clearing houses.

In addition, the proposal amends the definition of bona fide hedging to require that a hedge position be established and liquidated in an orderly manner in accordance with sound commercial practices. The Commission also states that it intends to impose a standard of "ordinary care" on bona fide hedgers when entering, maintaining an exiting the market. The Commission believes that "negligent" trading should be a sufficient basis for the Commission to disallow a bona fide hedging exemption. The CFTC also explained that it intends to apply its policy regarding orderly markets for purposes of disruptive trading practice prohibits to its orderly trading requirement for purposes of position limits. The standard of care for the proposed orderly trading requirement goes beyond the conduct standard under the Disruptive Trading Practices Policy Statement.[11] The policy statement only imposes liability for intentional or reckless conduct under Section 4c(a)(5)(B) and states "that accidental, or even negligent, trading, practices or conduct will not be a sufficient basis for the Commission to claim a violation . . ."[12]. The Commission should interpret the orderly trading requirement consistently with the disruptive trading practices rule and not further constrain market participant's ability to exit positions and effectively manage their risks.

Cross-Commodity Hedge Exemptions

Under the Commission's and exchanges' existing rules governing *bona fide* hedging positions, market participants can rely upon a cross-commodity hedging position where the "fluctuations in value of the position for future delivery are substantially related to the fluctuations in value of the actual or anticipated cash positions."[13] Both the Commission and the exchanges have a long and effective track record of administering this requirement. The Commission's Proposed Rule permits cross-commodity hedging based on a qualitative standard similar to its existing speculative position limits rule. However, the Proposed Rule includes a rebuttable presumption that a hedge is not eligible as a cross-commodity hedge if it does not meet a quantitative factor. The Commission proposes to adopt a non-exclusive safe harbor on the meaning of substantially related contracts that includes two factors: (a) qualitative factor: reasonable commercial relationship between the target commodity and the commodity underlying the commodity derivative contract; and (b) quantitative factor: reasonable quantitative correlation in light of available liquid commodity derivative contracts. The Commission will presume an appropriate quantitative relationship when the correlation, between first differences or returns in daily spot price series for the target commodity and the price series for the commodity underlying the derivative contract is at least 0.80 for a time period of at least

[11] CFTC Interpretive Guidance and Policy Statement on Disruptive Practices (May 20, 2013)
[12] See 78 Fed. Reg. 31890, 31895 (May 28, 2013).
[13] *See* CFTC Rule 1.3(z)(2)(iv); *see also Glossary*, CME GROUP, http://www.cmegroup.com/education/glossary.html (last visited Jan. 28, 2014) (glossary definition of "cross hedging").

36 months. The Commission also asserts that fluctuations in the value of electricity contracts typically will not be substantially related to fluctuations in the value of natural gas.

In the energy markets, it is common for companies to hedge multiple commodity risks, such as an electric utility hedging the commercial risks of its input (natural gas as fuel) and output (electric generation / deliverable electric energy). Cross-commodity hedging is also commonplace due to correlations between commodities. The correlation can often be highest out the curve with the correlation decreasing in the spot month. The Commission's proposed quantitative factor inappropriately measures correlation only between the spot prices of the target commodity and the spot prices of the commodity underlying a derivative contract to determine whether a cross-commodity hedge meets the rebuttable presumption of a *bona fide* hedge. This is not the same analysis that the exchanges or market participants use to make commercial judgments about the appropriateness of cross-commodity hedges. In certain commodities, the correlation between the target commodity and the commodity derivative contract is higher farther out the forward price curve. As such, using spot prices to make a correlation determination is problematic. For example, many market participants hedge long-term electricity price exposure with natural gas futures contracts because there is no liquidity in deferred electricity futures contracts. In addition, electricity futures contracts tend to have increased volatility in the spot month. As a result, most cross commodity hedging activity is done prior to the delivery month with market participants converting hedges to electricity futures contracts as the risk moves closer to or into the spot month. As such, using spot prices to make a correlation determination is problematic and could distort the correlation analysis. ICE believes the Commission should instead evaluate correlations in non-spot months further from expiration as this timeframe supports a more accurate correlation period and result for the cross commodity hedge correlations.

In addition, the quantitative test of correlation is not the appropriate measurement to allow the use of cross-commodity hedges. For example, when market participants hedge power with natural gas, they measure delta and delta hedge to offset the economic exposure of changes in power using natural gas because it is more liquid. If correlation testing is going to be part of the process, ICE believes the Commission should use a prospective test using the correlation of forward markets between the underlying and commodities beyond the spot month. Moreover, ICE recommends the Commission justify the 0.80 threshold and recognize that correlation out the curve is the relevant measure, not the spot month. In less liquid markets, the 0.80 is a difficult standard to meet.[14] Market participants engaging in hedge transactions should have flexibility to use a variety of tools for risk management and should not be constrained in this regard. ICE proposes that the Commission permit market participants to make commercially reasonable determinations of which contracts are substantially related rather than defining "substantially related" and requests that the Commission eliminate the proposed quantitative factor. By subjecting the cross commodity exemption to an 80% correlation, market participants' ability to

[14] ICE tested various cross commodity pairings using **non-spot** month data and found many pairings were still unable to meet the .80 correlation test. Upon request, ICE will provide this correlation data.

claim this exemption will be severally limited thus increasing price volatility and market participant risk.

Trade Options

The Commission proposes to subject Trade Options to position limits and considers Trade Options to be physical-delivery Referenced Contracts. ICE requests that the Commission exclude trade options from the definition of a Referenced Contract. Trade Options are commercial merchandising transactions done by companies in the normal course of business. They are not in the nature of speculative transactions and do not lend themselves to market manipulation. As such, ICE believes the Commission has an obligation to consider carefully the benefits and associated costs with any rulemaking in light of applicable statutory directives. Any rulemaking addressing position limits must account for the complexity of the products regulated and the tangible benefit of the regulation and be cost efficient. Trade Options are complex instruments which would require great expense to monitor and aggregate into position limits. Most Trade Options are not currently modeled in companies' risk management systems and the expense of compliance with the requirement would be great. There is little tangible benefit to subjecting Trade Options to position limits and no detrimental consequences by not including them in the definition of Referenced Contracts. Given these realities, our view is that including Trade Options in the definition of Referenced Contract would be costly and unnecessary.

It is also important to consider that the Commission currently does not have data on the open interest or deliverable supply estimates of Trade Options and thus cannot assess how the proposed spot and non-spot month limits would impact Trade Options. Due to the depth of variation between Trade Options it is extremely difficult to assess the open interest or deliverable supply estimates. Additionally, data on Trade Options was not considered by the Commission when setting levels for non-spot month limits, which could adversely impact market participants who hold positions in both physically-settled contracts and Trade Options. The 2011 position limit rule also did not explain or consider the consequences of treating commodity Trade Options as Referenced Contracts subject to speculative position limits, nor did it suggest how subjecting physical supply option contracts to position limits would be feasible. The inclusion of Trade Options could result in long-term deals counting toward the non-spot month limits, making it difficult, if not impossible for a commercial market participant to stay below the non-spot month limits. In addition, implementing a position limits compliance program that includes commodity Trade Options would be particularly challenging because of, among other things, the difficulty many market participants have had in distinguishing between Trade Options, forwards, and swaps.

Lastly, if the Commission considers Trade Options to be physical-delivery Referenced Contracts, holding a Trade Option prohibits market participants from availing themselves of the Conditional Limit on cash-settled contracts. This would be a drastic change from the current Conditional Limit exemption. Presently, physically-settled contracts are solely defined as

physically-settled futures contracts. Modifying this definition will limit market participant's ability to hedge their risks and reduce spot month liquidity.

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 remove the onerous requirements on bona fide hedging, spread, arbitrage and cross commodity exemptions that impact hedgers which we believe are contrary to the Commodity Exchange Act.

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

Sincerely,

Kara Dutta
IntercontinentalExchange

Atlanta Calgary Chicago Houston London New York Singapore

January 17, 2012

Mr. David Stawick
Secretary
Commodity Futures Trading Commission
1155 21st Street, NW
Washington, DC 20581

Re: Interim Final Position Limit Rules For Futures and Swaps

Dear Mr. Stawick:

IntercontinentalExchange, Inc.("ICE") appreciates the opportunity to comment on the Commodity Futures Trading Commission's ("CFTC" or "Commission") interim final rules position limits for futures and swaps (the "Interim Final Rules")

Since February 2010, the CFTC has provided for a "Conditional Limit" for financially settled natural gas contracts during the last three days of contract trading. Under the Conditional Limit, a market participant may carry a position in the financially-settled natural gas contracts (ICE H or NYMEX NN) that is up to 5 times that of the physically settled natural gas contract's (NYMEX NG) position limit if the participant agrees not to hold a position in the NG contract in the last three days. In the Commission's Interim Final Rules, the Commission codified the Conditional Limit with the addition that market participant can hold a position up to 4 times the NYMEX NG limit if the participant holds the maximum limit in the NG contract. As the Commission states in the final rulemaking: the "one to five ratio for natural gas maximizes the objectives as set forth in section 4a(a)(3) of the Act, of preventing excessive speculation and manipulation, ensuring market liquidity for bona fide hedgers, and promoting efficient price discovery."[1]

The Commission has already recognized the need for and benefits of the Conditional Limit.[2] The Interim Final Rule reaffirms this policy and recognition that many market participants have a need to pay or receive the final settlement price of the NG contract to perfect their hedges and that this is most effectively accomplished by holding cleared or bilateral swaps to expiration. Eliminating or decreasing the limit for cash-settled contracts would be a significant departure from current rules, which have the

[1] Position Limits for Futures and Swaps, 76 Fed. Reg. 71626 at 71637 (November 18, 2011)

[2] *See*, Federal Speculative Position Limits on Referenced Energy Contracts, 75 Fed. Reg. 4143 (January 26, 2010).

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

support of the broader market. In the nearly two years since the Conditional Limit rule went into effect, natural gas prices have been lower and less volatile than historical levels while having no or little impact on market liquidity for both the NYMEX NG contract and the ICE and NYMEX financially settled contracts.[3] In addition, convergence of the natural gas futures and spot markets has increased since the Conditional Limit has been in place.[4] Finally, a review of the comment letters received from market participants demonstrates support for the higher limit.[5]

In the final rule, the Commission should retain the five to one limit for natural gas contracts. In addition, given the benefits of the Conditional Limit, the Commission should reconsider expanding the five to one limit to other commodities as considered in the proposed position limit rule.

Sincerely,

R. Trabue Bland
VP, Regulatory Affairs
and Assistant General Counsel
IntercontinentalExchange, Inc.

---

[3] Position Limits for Futures Swaps, 76 Fed Reg. at 71636 (discussing impact of the conditional limit on market liquidity and volatility). *See also*, ICE Comment Letter submitted August 12, 2011 (discussing conditional limit and the impact on volatility).

[4] ICE Comment Letter at 7.

[5] *See, e.g.* Working Group of Commercial Energy Firms Comment Letter submitted August 16, 2011.

Atlanta Calgary Chicago Houston London New York Singapore

March 28, 2011

Mr. David Stawick
Secretary
Commodity Futures Trading Commission
1155 21st Street, NW
Washington, DC 20581

Re: Position Limits For Derivatives

Dear Mr. Stawick:

IntercontinentalExchange, 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 four regulated futures exchanges: ICE Futures U.S., ICE Futures Europe, ICE Futures Canada and the Chicago Climate Futures Exchange. ICE also owns and operates five derivatives clearinghouses: ICE Clear U.S., a Derivatives Clearing Organization ("DCO") under the Commodity Exchange Act ("Act"), located in New York and serving the markets of ICE Futures U.S.; ICE Clear Europe, a Recognized Clearing House located in London that serves ICE Futures Europe, ICE's OTC energy markets and also operates as ICE's European CDS clearinghouse; ICE Clear Canada, a recognized clearing house located in Winnipeg, Manitoba that serves the markets of ICE Futures Canada; The Clearing Corporation, a U.S.-based DCO; and ICE Trust, a U.S.-based CDS clearing house. As the operator of U.S. and international exchanges 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:

- Maintain the current position limit regime by allowing exchange specific spot month position limits;
- Allow higher position limits for financially settled contracts;
- Adopt position limits for the nearby months to expiration instead of an all months position limit;

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

- Keep arbitrage and spread exemptions; and
- Not implement onerous account aggregation rules.

Background

Section 737 of the Dodd-Frank Wall Street Reform and Consumer Protection Act[1] ("Dodd-Frank") gives the Commission the authority to set position limits for exchange traded futures and exchanged traded and over the counter swaps contracts. Section 4a of the Act[2] instructs the Commission to set limits "*as necessary* to diminish, eliminate, or prevent"[3] excessive speculation. Against this backdrop, the Commission has issued the Proposed Rules.

ICE believes that proper regulation is essential for ensuring that market participants— as well as the broader public — have confidence in the price formation process that takes place in our markets. This assurance of integrity lies at the heart of the exchange model. The U.S. energy futures and swaps markets, have permitted commercial and professional market users to hedge future price risk in an efficient and cost-effective manner. In particular, market participants have benefitted from intense competition between multiple exchanges, clearing houses and brokers to a degree unmatched in other markets.

As ICE has commented previously[4], the current position limit regime is outdated and does not take into account the existence of competing markets where economically equivalent contracts are traded across markets. In connection with its existing proposal, ICE supports the Commission's proposal to set aggregate position limits across trading venues for similar products outside of the spot month. Unlike other markets, liquidity is not concentrated at a single exchange or trading venue for energy commodities. Economically equivalent contracts may vary only where they are listed for trading or in how they are settled, and have repeatedly been shown to trade as a single market until the final days of trading. For example, the June 2007 report published by the U.S. Senate Permanent Subcommittee on Investigations entitled, "Excessive Speculation in the Natural Gas Market," focused on natural gas trading by the hedge fund, Amaranth Advisors, in both the NYMEX physical futures market and the ICE swaps market. The report is replete with analysis supporting the conclusion that these two markets, one

---

[1]Dodd-Frank Wall Street Reform and Consumer Protection Act, H.R. 4173 (July 21, 2010).

[2] 7 U.S.C. § 4a

[3] *Id.*

[4] http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=11688&SearchText=ice

physically settled and the other cash settled, were and are "functionally equivalent" and provide economically identical hedging and risk management functions."[5]

Given competitive markets and the fact that multiple exchanges are able to trade the same energy contract, ICE believes that the Commission, rather than the exchanges, is the appropriate, neutral authority to set and administer aggregate position limits and hedge exemptions for derivatives. Only the Commission is able to view a market participant's positions across all venues, and to administer aggregate position limits in an objective manner that promotes, rather than impedes, market competition.

Policies Underpinning the Proposal

It is often tempting for policy makers to take steps to address what they perceive to be structural problems in markets during times when markets are sending unpopular price signals. While well intentioned, these measures often fail to achieve their desired objectives or, worse, lead to unintended consequences such as increased price volatility and distortion of important price signals that would otherwise have been conveyed by a freely operating market. If policy changes are not narrowly focused and carefully tailored to address actual problems in the market, such changes could ultimately leave our country, its businesses, and American consumers in a worse position in the long run, unable to prepare today for what everyone – policy makers, businesses and consumers alike – agree will be a difficult energy future.

In its Proposed Rules, the Commission has proposed significant changes to the position limit regime for derivatives. Protecting the integrity of the derivatives markets from excessive speculation is a laudable goal, but it is important to note that the Commission has neither demonstrated nor determined that excessive speculation exists in the derivatives markets. As the Commission states in the Proposal, a finding of excessive speculation may not be required by the Act. However, it is vitally important that the Commission take action that reasonably addresses these issues. Tying position limits to excessive speculation, especially without a finding of excessive speculation, could lead

---

[5] *"The data analyzed by the Subcommittee, together with trader interviews, show that NYMEX and ICE are functionally equivalent markets. Natural gas traders use both markets; employing coordinated trading strategies…The data show that prices on one exchange affect the prices on the other."* ("Excessive Speculation in the Natural Gas Market", U.S. Senate Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, Sen. Carl Levin, Chairman, June 25, 2007, p. 3.)

"The ICE natural gas swap and the NYMEX natural gas futures contract perform the same economic functions." (Ibid, p. 29).

"*In sum, the structure of the ICE swaps and NYMEX futures contracts, the virtually identical prices of these two contracts, and the testimony of traders provide compelling evidence that the NYMEX natural gas futures contract and the corresponding ICE natural gas Henry Hub swap are economically indistinguishable financial instruments for risk-management purposes."* (Ibid, p. 36).

the Commission to play the role of price authority. Every unpopular price may lead to allegations of excess speculation and calls for the position limits to be adjusted.

In this regard, ICE notes that no quantitative investigation or quantitative study has demonstrated that speculation was the cause of increased commodity prices in 2008. Indeed, it is telling that commodities for which there was no active futures market experienced similar or even larger price increases as those for which there are active futures markets. In fact, the Commission's analysis of the oil markets in 2008 found no direct relationship between the run up in energy prices and speculative activity.[6] Subsequent enhancements to position reporting, including disaggregated historical and current large-trader reports, have also demonstrated that the U.S. energy markets offer a healthy balance of commercial and speculative interest, while failing to tie price increases with speculative buying. When setting policy, it is also critically important to recognize that deep, liquid markets, with broad speculative participation, are better at price discovery and are less susceptible to manipulation.

ICE believes that position limits should be set to prevent manipulation around contract expiry and delivery and to prevent delivery disruptions, and not with a goal to influence commodity price levels. In determining position limits, the Commission should consider the entire size of the relevant markets– both exchange-traded and OTC and both domestic and domestically linked. This is very important because the Proposed Rule may set position limits before the mandatory trading and clearing provisions of Dodd-Frank are fully in effect. Thus, the Proposed Rules will come at a time of significant flux in derivatives markets as market participants bringing business normally conducted bilaterally onto exchanges. By implementing an onerous position limit regime and limiting all financial and physically delivered contracts to deliverable supply, the Commission may inadvertently restrict the ability of market participants to put positions onto exchanges and clearing houses at the same time that Congress is requiring more, or all, positions be cleared and exchange traded.

Further, the Commission should set position limits not based upon current activity alone, but to permit growing participation in the derivatives markets. Failing to accurately assess market size and thus, liquidity needs, in setting position limits, accountability levels and appropriate exemptions will likely result in artificially low limits and create barriers to a well-functioning, centrally cleared, regulated and competitive derivatives market in the U.S.

---

[6] Interagency Task Force, *Interim Report on Crude Oil*, July 2008. http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/itfinterimreportoncrudeoil0708.pdf. *See also,* IOSCO Task Force on Commodity Markets, *Final Report*, March 2009 (stating that the proposition that the activity of speculators has systematically driven commodity market cash or futures prices up or down on a sustained basis is not supported). https://www.iosco.org/library/pubdocs/pdf/IOSCOPD285.pdf

Finally, Section 737(a)(2)(C) of Dodd-Frank instructs the Commission to set position limits that "will not cause price discovery in the commodity to shift to trading on…foreign boards of trade." The Commission should be aware that over the next few years, price discovery of commodities will shift naturally from the U.S. because demand from developing nations like China and India will greatly increase. Thus, in the futures, U.S. consumption will not be the sole determining factor for commodity prices. The central issue for the Commission is whether the proposed limits will constrain trading in the U.S. and serve as a catalyst to increase movement of trading from the U.S. to foreign markets.

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

Aggregate Spot Month Position 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. 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.

Limiting positions across exchanges based upon deliverable supply could have negative consequences for firms requiring risk management of and/or exposure to energy prices. For example, certain energy contracts, such as Henry Hub natural gas or West Texas Intermediate crude oil, represent the national or international price of a commodity, and are used by firms to approximate the national price of that commodity in their hedging strategies. These firms are not participants in the physical delivery process and the location of the physical hub is of no importance. What is important, however, is their ability to hedge their exposure to an established benchmark. For example, the market created an OTC financially settled WTI swap contract specifically to allow hedgers, who reference CME's WTI futures settlement price in their physical crude oil purchase and

sale contracts, to hedge the expiration price used in such contracts. Without such a mechanism, it is impossible to hedge the final futures settlement price, as a party would be forced to trade out of its position before final settlement or take delivery of physical crude oil at expiration.

In addition, aggregating positions across exchanges in the spot month will severely limit the size of the energy markets. This is a radical change from current practice and the Commission's previous proposal for position limits for energy contracts which allowed for limits at each exchange.[7] In the case of Henry Hub, absent an exemption, a trader can take to delivery 1,000 contracts in the CME physically settled contract (commodity code NG), the CME financially settled contract (commodity code NN), and the ICE financially settled swap (commodity code H)[8] for a total of 3,000 contracts. Under the Proposal, a trader can only take 2,000 contracts into delivery (1,000 in the financially settled contract, 1,000 in the physically settled contract), a 1/3 decrease in the total amount of contracts available to any trader. This decrease could severely hamper the ability of firms to efficiently hedge their exposure given that hedgers need speculators in the market. In addition, an aggregate spot month position limit may limit the competition among Swap Execution Facilities ("SEFs") envisioned by Dodd-Frank because the aggregate spot month limit will provide little room for a new market to compete given that the size of the energy market will be frozen at a set level of contracts at the spot month. A trader is unlikely to participate on a SEF without the ability to trade in the spot month.

Finally, the Commission should be aware that a low aggregate limit may shift price discovery from key benchmark contracts. As noted, 25% of the deliverable supply at Henry Hub is roughly equivalent to 1,000 NG contracts, which is relatively small compared to other delivery points like the Alberta AECO natural gas hub, which has a far larger deliverable capacity. Shifting price discovery from a long standing contract like Henry Hub may have a significant impact on existing physical supply contracts, such as long term natural gas delivery contracts to power generators. Before implementing this limit, the Commission should study whether aggregated spot month position limits will artificially constrain these markets.

ICE recommends that the Commission adopt the spot month position limit rules from its 2010 position limit proposal under which each exchange is permitted to set spot month position limits based upon deliverable supply. This rule would address the

---

[7] Federal Speculative Position Limits on Referenced Energy Contracts, 75 Fed. Reg. 4143 (January 26, 2010).

[8] ICE's Henry Hub swap is a quarter size of the CME NG futures contract, but for the purposes of the example, the Henry Hub swap is converted to the NG equivalent (i.e. each contract is 10,000 mmbtus).

Commission's concerns about corners and squeezes during delivery, while allowing enough capacity for traders to participate in these contracts at expiration. In addition, exchange specific spot month limits will allow for more competition as new entrants such as SEFs will have room to grow. To satisfy its concerns about trading across exchanges, the CFTC could monitor spot month trading from an aggregate basis across all SEFs and exchanges for impact on price.

Spot Month Limits for Financially and Physically Settled Contracts

The Commission should be commended for recognizing the distinction between financially settled and physically settled contracts by proposing that a trader in a financially settled contract be permitted, based upon a conditional position limit, to take a speculative position five times the spot month position limit for the physical contract if the trader exits the physically settled market in the spot month. However, this conditional limit should be refined to fit the market as it currently operates, which is based upon the needs of market participants. In this regard, the Commission should consider (i) whether forcing these participants to leave the physically settled contract a full three days in advance of expiration is appropriate given the differences between physically and financially settled contracts, and (ii) whether having speculative traders exit the physical contract in this manner will impair price discovery by reducing liquidity and concentrating pricing power among a smaller group of market participants. Previous Congressional and Commission reviews of the energy markets have found that financially and physically settled contracts behave differently at expiration. As the Senate Permanent Subcommittee on Investigations states in its Report on Excessive Speculation in the Natural Gas Market:

> "[B]ecause the final settlement price for the ICE swap is defined to be the final settlement price of the NYMEX futures contract for the same month, the most significant divergence in price between the two contracts often ***occurs during the final 30 minutes of trading for the NYMEX contract***, which is used to compute the final NYMEX contract price. (The NYMEX final settlement price is computed by taking the volume-weighted average price of all trades during the final 30-minute period.) Most of the trading during these final 30 minutes will occur on NYMEX rather than ICE, and hence the NYMEX price often will "lead" the ICE price during this period. Based on the ICE and NYMEX data reviewed by the Subcommittee, as well as trader interviews, this final settlement

period is the only period in which it can be categorically stated that one exchange "leads" the other in price."[9] (emphasis supplied)

Given compelling findings by the Commission and Congress that physically and financially settled contracts trade differently on the last day of expiration, ICE recommends that the Commission adopt a separate position limit regime for financially settled contracts, adopting the five times deliverable supply limit as the limit (or higher if the Commission adopts aggregate spot month limits across exchanges). Alternatively, if the Commission choses to keep the conditional limit as written, the Commission should remove the three-day prohibition from the conditional limit or limiting the "no trade" period for the physically delivered contract to a narrower window of trading than the final three days of trading.

Finally, if the Commission decides to adopt an aggregate spot month limit across exchanges, it should increase the conditional limit. As noted above, an aggregate spot month limit will decrease the amount of contracts available for traders to take into delivery. To accommodate current levels of participation, the Commission should increase the conditional limit to at least ten times the speculative limit.

Position Limits in Non-Spot Months

The Proposal also sets aggregate position limits in all contract months. The limits would be set by the Commission as a specific percentage of the current open interest in the referenced contracts. As noted previously, Dodd-Frank's mandatory trading and clearing requirements are likely to drastically change the exchange traded derivatives markets as participants move business that is traditionally conducted bilaterally onto exchanges. While the Commission is taking a phased approach, setting position limits while the market is in flux could artificially constrain trading. Again, this could discourage trading on U.S. exchanges and force trading overseas.

The Proposal sets two limits, one limit set on the overall market and one limit set by contract class. The class limits would be set on two classes: futures and options and all swaps. Setting limits on economically equivalent classes undercuts the Commission's rationale for setting limits on the swaps markets in the first place. Exhaustive hearings by Congress and the Commission over the last several years have concluded that economically equivalent contracts traded on two separate exchanges operate as a single aggregate market. For example, testifying before the House Agriculture Committee, Subcommittee on General Farm Commodities and Risk Management, in September 2007, Dr. James Newsome, former Commission Chair and then President of NYMEX, stated

[9] Id, p. 34.

“the two competing trading venues [ICE and NYMEX] are now tightly linked and highly interactive and in essence are simply two components of a broader derivatives market.”[10] Further, as outlined in the Commission’s Report on Exempt Commercial Markets, one of the Commission’s underpinnings of regulations for exempt commercial markets (ECMs) was that financially settled contracts could be arbitraged (and therefore affect) a physically settled contract.[11] Against this backdrop, the idea of imposing limit on a class of economically equivalent contracts is logically flawed. As the Commission has noted, the swaps and futures markets operate as one, at least until expiration. Setting limits by class is unnecessary and the Commission should adopt one aggregate limit for all economically equivalent contracts.

Furthermore, 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 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 axiomatic that the farther into the future an expression of price is made by a speculative market participant, the less connected or relevant such an expression is likely to be to the current spot market price. To promote greater liquidity in longer dated portions of the price curve, which would benefit commercial users attempting to hedge long dated risk,the Commission should consider implementing its “all month” limit only on the front portion of the trading curve – for example, the first eighteen contract months – and maintain a position accountability regime for longer dated portions of the trading curve beyond that period.

It is 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 first eighteen 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.

---

[10] Testimony of Dr. James Newsome, Chief Executive Officer, New York Mercantile Exchange, before the Subcommittee on General Farm Commodities and Risk Management, United States House of Representatives (September 26, 2007).

[11] Commodity Futures Trading Commission Report on Exempt Commercial Markets (October 2007). http://www.cftc.gov/stellent/groups/public/@newsroom/documents/file/pr5403-07_ecmreport.pdf

The Commission should 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 tomorrows 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 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.[12]

Bona Fide Hedge Exemptions

The Commodity Exchange Act states that, **“[**n]o, rule, regulation, or order issued under subsection (a) of this section shall apply to transactions or positions which are shown to be *bona fide* hedging transactions or positions . . . Dodd-Frank directs the Commission to define a *bona fide* hedge exemption as off sets of cash market transactions. This new definition of a *bona fide* hedging transaction is far more limited than the current Commission regulation § 1.3(z)(1) and will constrain the ability of firms to use the derivatives markets to hedge. Added to the narrowed exemption in Dodd-

[12] 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.

Frank, the Commission's procedure for granting and maintaining *bona fide* hedge exemptions is needlessly complex and will impose a large operational burden on market participants. In addition, the elimination of spread and arbitrage exemptions will impede the price discovery process on derivatives exchanges.

In general, the Proposal extends the program for granting *bona fide* hedges that currently exists for the enumerated agricultural commodities to energy contracts. However, the proposed rules do not recognize that commercial market practices in these markets differ from those in the enumerated agricultural products and that, consequently, merely extending the current Commission program to these commodities will create a flawed system. 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. In particular, we are concerned that the Proposed Rules could needlessly prevent such participants from fully managing their commercial risk through futures, options and OTC instruments that are cleared through entities regulated by the Commission.

For instance, the Proposal eliminates the spread and arbitrage exemption that is currently recognized by exchanges. In ICE's energy contracts, the spread and arbitrage exemptions are vitally important to the functioning of the markets because they allow participants to hedge risk assumed through the normal course of business. ICE uses the spread exemption to allow traders to spread positions between the Henry Hub natural gas contract and natural gas basis points. Hedging basis risk allows a trader to hedge the cost of delivering natural gas to any particular point in the country. Given that the Commission is not aggregating basis contracts as referenced energy contracts, a spread exemption for these transactions is vitally necessary to allow traders to hedge basis risk in natural gas.

The arbitrage exemption is also critical to the energy markets by allowing, as the Commission recognizes, the arbitrage of economically equivalent contracts to create one market.[13] Arbitraging ensures that if one market does not reflect fundamentals, it will eventually be brought back into line with other markets, which greatly decreases the risk of a market being manipulated over the long term. In addition, the open access provisions of Dodd-Frank encourage the listing of economically equivalent swaps by SEFs. Without arbitraging, prices of equivalent swaps on these SEFs could begin to diverge, presenting opportunities for malfeasance by traders. Additionally, divergent prices on economically equivalent contracts could ultimately create misleading settlement prices, which in turn could present greater risk to clearinghouses.

---

[13] *See, e.g.*, Commodity Futures Trading Commission Report on Exempt Commercial Markets

In addition, the proposed procedures for granting and maintaining exemptions are unnecessarily complex and will create an extremely large burden on market participants. For example, Proposed Rule §151.5(c) requires that any trader who wishes to exceed position limits to hedge unsold anticipated commercial production or unfilled anticipated commercial requirements submit a Form 404A filing at least ten days before positions would exceed applicable limits. This filing would include information about the trader's production or requirements for the relevant commodity for the past three years. The Commission indicates that it will review the data and determine whether to approve an exemption after determining whether all or a portion of the anticipated production or requirements should be deemed *bona fide* hedging. Although the regulation contemplates a response to be issued within 10 days, the Commission may ask for additional information and no time frame is given for a response in that situation. At the very least, the Commission should commit to providing a response by a certain day so that a commercial participant is not prohibited, by delay or inaction on the part of the Commission, from establishing what it considers to be a *bona fide* hedge position in a timely manner.

The proposed regulations also requires a hedger to submit a Form 404 filing by the business day following the day the limits were exceeded. Most exchanges have rules providing that, if a trader exceeds a position limit due to sudden unforeseen increases in its *bona fide* hedging needs, the trader may request an exemption within five or ten days, depending on the contract, and if the exemption is granted, then the trader will not be considered in violation of the position limit rules. ICE recommends that a similar approach be taken by the Commission and codified in the proposed rules.

Additionally, the reporting requirements for *bona fide* hedging swap counterparties will put an extremely large burden on market participants and will be prohibitively complicated in regards to the Commission accurately tracking bona fide hedging positions. In particular, §151.5(g) states, in part, that "[u]pon entering into a swap transaction where at least one party is relying on a bona fide hedge exemption to exceed the position limits" the participants need to exchange written representation verifying that the swap being transacted qualifies as a bona fide hedging transaction for at least one of the participants. This information needs to be exchanged for each such swap transaction, maintained by the counterparties, and submitted to the Commission in a Form 404s for everyday in which the participant exceeds the limits. This documentation requirement is excessive and will not efficiently meet the Commission's goal of tracking bona fide exposure in swap transactions. This goal could more effectively be accomplished through an annual exemption filing process.

Account Aggregation

Currently, pursuant to the Commission's position limit rules, an account is aggregated for position limit purposes where a person owns 10% or greater of a common entity. However, if an account is independently controlled, then the position is not aggregated. This makes sense, for example, in the case of two independent operating companies of a corporate parent who independently trade under the same corporate entity, because they are not viewed as trading for the same account.

The Proposal establishes stricter aggregation standards than those currently in force. A limited exemption is provided to disaggregate positions in certain situations. To receive the exemption, the requestor must submit an application to the Commission containing extensive information. No timeframe is provided for a response to the application, raising the possibility that the requestor might have to operate for an extensive time without knowing how its positions will be treated and whether it will be in violation of applicable limits. It is possible that the proposed change in aggregation standards could impact operations in ways that may not have been anticipated by the Commission. If accounts that currently are reported separately in large trader reports and for open interest have to be aggregated under the Proposed Rules, it could result in a reduction in open interest, which could have a market impact if open interest is significantly reduced. Accordingly, the Commission should study this issue more carefully and satisfy itself that there will not be unintended, harmful market consequences, before it determines whether to introduce this change.

The proposal's departure from the Commission's Part 150 standards also may be unworkable and surely will drive up the cost of compliance without offering associated market benefits. Firms with decentralized and international trading operations through multiple independent account controllers would find it extremely difficult, and very costly, to track position limit levels for each of these disparate trading operations in the contracts affected by the proposal.

Conclusion

ICE commends the Commission for undertaking a comprehensive review of the position limit regime for derivatives and we appreciate the opportunity to comment. We ask that the Commission be prudent in enacting a position limit regime and remain mindful of the consequences of miscalculation.

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

Sincerely,

R. Trabue Bland
IntercontinentalExchange, Inc.