Intercontinental Exchange’s Position Paper on implementing new regulatory requirements for Coffee and Cocoa

To enable new regulatory requirements around coffee and cocoa to achieve their policy goals and to minimize any adverse impact on the global coffee and cocoa pricing mechanisms Intercontinental Exchange ("ICE") requests:

a) 36 months implementation lead time for new regulatory requirements and
b) Grandfathering provisions for pre-existing EU physical coffee and cocoa inventories from any new regulatory requirements

Such measures would enable an orderly transition to the new regulatory environment. Without them there is a clear danger of market disruption, which could severely impact European businesses and origin farmers, and compromise the wider sustainability goals of the regulation.

Introduction

ICE is supportive of regulatory initiatives which improve the supply chains of agricultural products, as well as the communities in which they operate i.e. origin farmers. ICE is the operator of agricultural futures and options markets for products such as coffee, cocoa, sugar and wheat.

These Futures contracts are used by market participants along the commodity value chain to manage their business risks by protecting themselves against adverse price movements, a process known as hedging. The risk management function along the value chain allows participants to plan for and control the input costs to their manufacturing process, and ultimately the costs for their finished food products which are sold in Europe and throughout the world.

ICE’s Coffee C® Contract (Arabica), Robusta Coffee Contract and London Cocoa Contract are futures contracts which provide price transparency and efficiency to those markets on a global scale. These contracts are agreements to buy or sell a particular asset (i.e. coffee or cocoa) at a predetermined price, with payment and delivery at a specified time in the future. Futures contracts are standardized for quality and quantity to facilitate trading across a broad range of participants along the commodity value chain.

The orderly functioning of the cocoa and coffee futures and options markets is dependent on certified inventories of known quality specifications which can be made readily available for delivery. Transparency of the available inventory, and certainty that the inventory can be used in the European markets in which it is stored, is critical in ensuring that the Exchange contract price represents the market’s assessment of the future commercial value of the underlying commodity. Absent this convergence of the futures contract price and the underlying commodity price, the futures markets would no longer be an effective risk management tool for producers, processors, manufacturers and all other participants throughout the global supply chain.
ICE Coffee ‘C’ Contract

The Coffee ‘C’ Contract is the global benchmark price for Arabica coffee. As such, the contract price is the baseline price for transactions throughout the global supply-chain, allowing farmers, processors, and consumers to hedge their exposure and protect themselves from adverse price movements. Participants in the Coffee ‘C’ Contract currently hold over 2 million bags of ICE Certified coffee inventories in warehouses across Europe, which represents over 90% of the total certified inventory. Futures contracts are listed for trading up to three years prior to the delivery period.

ICE Robusta Coffee Contract

Similar to the Coffee ‘C’ Contract, The Robusta Coffee Contract is the global benchmark price for Robusta coffee and the baseline price for transactions across the global supply-chain. Participants in the Robusta Coffee Contract currently hold approximately 120,000 MT of ICE Certified coffee inventories in warehouses across Europe, which has been stored for periods of up to 7 years. Futures contracts are listed for trading up to two years prior to the delivery period.

ICE London Cocoa Contract

ICE’s London Cocoa Contract is the European benchmark price for cocoa. As such, it is the baseline for all European transactions and a reference point for much of the global cocoa supply-chain, allowing farmers (particularly in West Africa), processors, manufacturers and consumers to hedge their exposure. Participants in the Cocoa Contract have stored up to 350,000 MT of ICE certified inventory in warehouses across Europe, with an age that can vary from 1 to 20 years. Futures contracts are listed for trading up to two years prior to the delivery period.

Interaction between regulation and ICE’s Robusta Coffee and Cocoa Contracts

Every futures contract has a standardized set of contract rules which market participants must follow. In the case of coffee and cocoa, these rules include specific quality requirements for the goods that can be physically delivered. As the goods are in warehouses in ports across Europe, EU regulations directly impact these quality requirements, and the availability of goods which meet those requirements.

EU regulation which impacts the physical commodity underlying a futures contract also impacts that contract’s functioning. Consequently, regulatory requirements applicable to coffee and cocoa will have an impact on the functioning of ICE’s Coffee and Cocoa contracts, and will therefore impact the global price-forming mechanism that the contracts provide, with a direct impact on businesses in Europe and farmers in the origin countries that participate in the value chain for coffee and cocoa.

ICE Certified coffee and cocoa physical inventories must be fungible and usable in the locations and markets where they are stored so they can be a direct replacement for a manufacturer’s physical inventories, and therefore represent the value of those inventories.

In a scenario whereby regulatory requirements render the ICE Certified warehouse inventory unusable as a direct replacement, then the price of the unusable inventory will decrease to a level that makes this Intercontinental Exchange
coffee or cocoa inventory appeal to non-EU markets for use. The immediate impact is likely to be volatile pricing, and in the medium to long term the effectiveness of the futures contracts as price discovery and risk management tools is undermined. Businesses in Europe and governments and farmers in origin countries will struggle to forecast prices and plan their operations as the market price will not react as efficiently in response to changes in supply and demand.

To minimize any adverse impact on the global coffee and cocoa pricing mechanisms ICE requests:

a) **36 months lead time for rule changes to the future contracts**

Any regulatory change which does not have at least a 36 months lead time will create a divergence between the EU standards and the futures contract terms and conditions. ICE’s Futures contracts are listed with expiration dates up to 3 years in the future, in order for consumers and producers to be able to manage price risk and plan effectively for 1 or 2 agricultural cycles. It is de-stabilizing and unadvisable to change the rules of already listed “live” contracts. Substantial changes to the contract can only be implemented as new contracts come online with a 24 months lead time. In addition, significant regulatory changes should be known to market participants at least 12 months before the new contract goes live, to allow ICE to make the necessary changes in coordination with the relevant market participants along the commodity value chain. **Therefore, ICE would request 36 months implementation lead time, to allow for the correct adaption of the future contract to new regulatory requirements, minimizing adverse impacts on the global pricing mechanism.**

b) **Grandfathering of existing EU inventory**

The cut-off date for the acceptance of pre-existing inventory and the implementation of new regulations is extremely important. Without sufficient prior notice, pre-existing inventory will be rendered in breach of the new regulations and becomes effectively worthless in its local market. There would be an immediate restrictive impact on supply. **These two aspects could create extreme price volatility and uncertainty,** which would mean extremely difficult business conditions for the whole coffee and cocoa industry and would have a damaging impact on the livelihood of the coffee and cocoa farmers at origin.

**Therefore, ICE would suggest that existing inventory warehoused in the EU should be exempted from new regulatory requirements, and instead be steadily removed from the market via an appropriate ‘grandfathering’ approach.**

**Contact Details:**

Intercontinental Exchange

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