



Alternative Investment Management Association

David Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW.
Washington DC
20581
U.S.A.

By email to: secretary@cftc.gov

26 April 2010

Dear Mr Stawick,

The Alternative Investment Management Association (AIMA)¹ appreciates the opportunity to comment on the Commodity Futures Trading Commission's (the 'CFTC') 'Proposed Federal Speculative Position Limits for Referenced Energy Contracts and Associated Regulations' (the 'Position Limits Proposal').

AIMA's comments

AIMA agrees with the Position Limits Proposal's aim to "diminish, eliminate or prevent excessive speculation causing sudden or unreasonable fluctuations in the price of a commodity, or unwarranted changes in the price of a commodity". AIMA additionally supports any measures by the CFTC which would prevent or address market abuse or market manipulation in any form, and believes that it is right that the CFTC should have flexible powers to address these issues. However, we would note that it is vital that the CFTC strives towards a market that is efficient, liquid and transparent, governed by supply and demand, and one which produces a fair settlement price.

We do not believe that position limits, whether alone or as part of a wider solution, necessarily achieve this goal, and they may even counteract such goals if wrongly applied.

Where excessive speculation forms part of a market participant's attempts to manipulate market prices or where such speculation forms part of practices amounting to market abuse, then of course it should be suitably addressed. However, the main cause of price volatility has been driven by supply and demand, so that volatility would not be sufficiently addressed by imposing position limits, except to the extent that such limits would restrict all functioning of the market - excessive speculative trading and normal legitimate trading.

The CFTC would be able to evaluate the effect of such position limits by considering the prices of the covered energy contracts as they approach expiry. Low volatility and a stable approach to settlement price would indicate a successful outcome, while high volatility with difficulty in establishing a fair settlement price would indicate that the market was hindered in its ability to establish a fair settlement price. Previous historic implementations of substantial position limits have shown that position limits, where applied, were rapidly changed or repealed and did not achieve the intended goal when settlement prices became volatile and difficult to predict.

¹ AIMA is the trade body for the hedge fund industry globally; our membership represents all constituencies within the sector - including hedge fund managers, fund of hedge funds managers, prime brokers, fund administrators, accountants and lawyers. Our membership comprises over 1,100 corporate bodies in over 40 countries, with over 10% based in the US and over 30% of AIMA members' total assets under management (AUM) managed by US investment advisers.

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A preferred alternative approach may be to impose position limits on physical commodity futures contracts as they approach expiry, and grant no exemptions to such limits. This would, at least, address unfair settlement prices and protect real economy producers seeking to buy crude oil, natural gas, gasoline and heating oil in the market. Alternatively, we suggest that the CFTC should consider the methods used in the equities markets, where market participants who own a large percentage of a stock are restricted in their ability to trade (rather than constrained by a hard limit).

To the extent that the CFTC decides that the energy contract position limits as proposed are necessary to address the stated goals and by reference to the questions posed in the Proposals, AIMA believes that:

- contracts that do not cash settle to the price of a single contract but settle to the average price of a sub-group of contracts within a class should be calculated using Delta-equivalent measures during the spot month for the purposes of enforcing the proposed speculative position limits (question 4);
- the limits proposed under regulation 151.2(b)(1)(i) as all-months-combined aggregate position limits would be adequate to achieve the stated aims (subject to our comments above) (question 5);
- customary position sizes held by speculative traders should be considered as a factor in moderating the limit levels proposed by the CFTC (question 6);
- the CFTC should publish acceptable practices that adopt formal guidelines and procedures for implementing position accountability rules (question 7);
- there is even less necessity to impose position limits in other contracts of physical supply, where similar effects may be felt in terms of efficiency, liquidity, transparency and proper settlement price discovery. Additionally, the US market in contracts such as metals is significantly smaller than those in energy contracts, and have yet to indicate any real issue with speculative price increases (question 11);
- international cooperation and coordination of any regulatory rules is desirable although we acknowledge that agreement is not always possible; it is our understanding that many other major financial centres have rejected the introduction of position limits in any form (question 12);
- if the CFTC is granted additional authority by Congress to extend position limits beyond positions in reporting market contracts, to reach positions in over-the-counter (OTC) derivative instruments and foreign board of trade (FBOT) contracts, the current position limit rules should be sufficiently flexible that the CFTC can make the amendment and update the rules for its latest mandate. To the extent that the Position Limit Proposal is effective, the inclusion of OTC markets may improve any effect over implementation only in the exchange-traded market, which should be explored further (question 13);
- market participants require clarity and certainty in the application of any rules that market regulators set, in general preferring strict and transparent methodologies to which they can adhere. Although flexibility and frequent reviews sound helpful in principle, in practice position limits should not be amended so often that significant compliance burdens and costs are imposed on market participants. We would, therefore, suggest that amendments to position limits set should not occur more frequently than once per year, except where the CFTC considers it urgent that it should do so (i.e. in response to a specific issue or event). If the CFTC does decide to conduct more frequent reviews of the position limits, its methodology should be transparent and require that the data is easily obtainable by all users. AIMA has additionally had sight of a response to this CFTC consultation by one of our members, Winton Capital Management Limited; we agree with and support

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that respondent's analysis and comments on the issues raised by seasonal fluctuations causing position limits to have weaker and stronger effect at various points during the cycle (question 14);

- large, passive, and unleveraged long-only positions should not be given a separate market space and should not be subject to separate rules. It is best not to categorise investors and apply differing rules or limits as this can lead to bargaining and creation of avoidance measures by market participants. To accommodate passive investors, one could restrict trading activity above a certain level (rather than enforcing hard limits on position size) (question 15); and
- the proposed definition of contracts of the same class for spot and non-spot months is sufficiently inclusive. It is also appropriate to define contracts of the same class during spot months to include only contracts that expire on the same day (question 16).

Conclusion

If the Position Limit Proposals are implemented, they will not sufficiently accomplish the goals of addressing excessive market speculation and could, as a result, have certain negative effects on the proper functioning of the markets. The CFTC should instead focus its efforts on addressing market volatility caused by market abuse and manipulation. If the CFTC does implement such rules, in addition to likely market disruption, some current market participants may be expected to trade their investments to non-US exchanges instead.

We thank you for this opportunity to comment on the Position Limits Proposal and we would be happy to discuss in greater detail any of comments above.

Yours sincerely,

Mary Richardson
Director of Regulatory & Tax Department