10-002
COMMENT
CL-02714

CME Group
A CME/Chicago Board of Trade/NYMEX Company

Craig S. Donohue
Chief Executive Officer

April 26, 2010

VIA ELECTRONIC MAIL
David Stawick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581
secretary@cftc.gov

Re: CFTC Proposed Rulemaking on "Federal Speculative Position Limits for Referenced Energy Contracts and Associated Regulations", 75 Fed. Reg. 4144 (Jan. 26, 2010)

Dear Mr. Stawick:

CME Group is the holding company for four separate Exchanges, including the Chicago Mercantile Exchange Inc. ("CME"), the Board of Trade of the City of Chicago, Inc. ("CBOT"), the New York Mercantile Exchange, Inc. ("NYMEX") and the Commodity Exchange, Inc. ("COMEX"). CME Group, on behalf of its four designated contract markets (collectively, the "CME Group Exchanges" or "Exchanges" or "DCMs"), appreciates the opportunity to provide its views to the Commodity Futures Trading Commission (the "CFTC" or "Commission") on its Notice of Proposed Rulemaking entitled "Federal Speculative Position Limits for Referenced Energy Contracts and Associated Regulations." (the "Proposal").[1]

The CME Group Exchanges offer the widest range of benchmark products available across all major asset classes, including futures and options on futures based on interest rates, equity indexes, foreign exchange, energy, metals, agricultural commodities, and alternative investment products. CME Clearing is one of the largest central counterparty clearing services in the world; it provides clearing and settlement services for exchange-traded contracts, as well as for over-the-counter ("OTC") derivatives contracts through CME ClearPort®. Using the CME ClearPort® service, eligible participants can execute an OTC swap transaction, which for many of our products can be transformed into a futures or options contract that is subject to the full range of Commission and exchange-based regulation and reporting. The ClearPort® service mitigates counterparty credit risks, provides transparency to OTC transactions and brings to bear the exchange's market surveillance monitoring tools. The CME Group Exchanges serve the hedging, risk management and trading needs of our global customer base by facilitating transactions through the CME Globex® electronic trading platform, our open outcry trading facilities in New York and Chicago, as well as through privately negotiated transactions.

[1]We have included with this comment letter a related appendix that contains responses to the specific questions contained in the Proposal.

We fully appreciate the Commission's longstanding commitment to carrying out its statutory mission to foster liquid and efficient markets, effective price discovery and transparency of market information. CME Group is committed to these same core values. However, for the reasons set forth below, CME Group respectfully requests that the Commission not adopt the Proposal. At a minimum, in view of pending legislation in Congress that is expected to provide the CFTC with broader authority over additional OTC venues, including with respect to the setting of position limits, we would urge the Commission to defer further action on the Proposal until the legislative process has been completed.

Section 4a(a) of the Commodity Exchange Act (the "CEA" or "Act"), provides the Commission with the authority to set position limits in certain circumstances in order to prevent damage to commerce from "excessive speculation". The Proposal is based on the stated desire to address perceptions of "uncontrolled speculation" and "excessive concentration" in the energy markets. Despite the political rhetoric, the assertion that "speculators" are driving energy price increases is factually incorrect and unfairly villainizes the role of speculators. In fact, speculation is crucial for a fully-functioning market environment, and the CEA specifically restricts the basis on which the Commission may act to limit it.

Traders who take speculative positions play a critical role, along with hedgers, market makers, arbitrageurs and other participants, in ensuring that exchange-listed markets serve the public interest as efficient risk transference and price discovery mechanisms. Speculators assume the risk of price changes over time that hedgers seek to reduce, and speculators bring to the market additional views on the future direction of prices. Exchanges like the CME Group Exchanges adopt and enforce speculative position limits and accountability levels for commodity products in order to manage risks and enhance transparency.

I. Overview

There has been substantial public concern with volatility and price increases in commodity markets, and we respect the Commission's efforts to assess the facts and ensure that public concerns are addressed with thorough evaluations, explanations and, where necessary and appropriately authorized, affirmative corrective action. As noted below in Section II, however, the regulatory process in this matter has created a level of uncertainty that has already caused a shift in activity away from the regulated markets based on the mere threat of restrictive new position limits. Moreover, the United Kingdom, the largest derivatives market outside the United States has signaled that it does not intend to impose position limits on the UK markets. Similarly, no other foreign jurisdiction has demonstrated an intention to impose position limits.

If implemented, the Proposal would exacerbate further the shift away from transparent CFTC-regulated markets to less restrictive venues. Moreover, market participants would necessarily remain uncertain of what further changes might quickly follow based on the results of legislative processes. For these very practical reasons, we urge the Commission to take a clear stand and determine not to adopt the Proposal, or, at a minimum, affirmatively determine to defer further action until after Congress has acted, and until the Commission then has considered whether to withdraw or modify any of its recommendations and has further provided ample opportunity for public review and comment.

In addition, in our view, the factual and statutory basis required for the Commission to impose new Federal speculative position limits on markets for listed energy products has not been established by the Commission. In Sections IV. through VI., we outline the legal requirements and review the factual record. We conclude that the Commission should not seek to impose additional position limits in these products above and beyond those established by the exchanges in the absence of a clear finding, as required by statute, that enhanced Federal restrictions are "necessary" to prevent an identified actual or threatened burden on interstate commerce caused by "excessive" speculation. The Commission has neither made such a finding nor suggested any basis in the Proposal for making such a finding, and the facts do not support one. As has been set forth in numerous research studies, including studies by the CFTC's own staff, and including multiple papers published since the Commission began to explore public concerns about price fluctuations in the energy markets, there is no credible evidence that speculative positions in the futures markets, rather than market fundamentals, have adversely impacted energy prices. In fact, the evidence clearly shows that the prices reflect market fundamentals.

In Section VII, we review exchange enforcement and market surveillance programs to prevent price manipulation and other illegal and unacceptable practices. The CME Group Exchanges' regulatory framework and that of other markets currently regulated by the CFTC are structured and enforced to effectively address the concerns to which the Proposal is directed. There is an established structure and long historical practice under which exchanges set position limits and the CFTC would only act if the CFTC concluded that the exchange programs fell short of what was "necessary". To the contrary, however, the CFTC has made no suggestion or indication that current exchange programs are inadequate. In fact, periodic reviews by Commission staff have routinely confirmed the adequacy of exchange market surveillance programs. Consequently, the limits set forth in the Proposal are not necessary because existing exchange programs adequately address excessive speculation concerns on those markets.

As we explained in our 2009 "White Paper"[2], we continue to support an approach under which hard limits are set and exemption programs are administered by the exchanges. Exercising its best judgment as a self-regulatory organization, a regulated exchange can evaluate a wide variety of relevant inputs, and may factor public concerns among them. However, the standards set forth in Section 4a(a) of the CEA for direct action by the Commission to adopt Federal position limits are more stringent. The Commission may, though it is not required to, impose its own position limits, but only if such limits are "necessary" to achieve specific objectives supported by factual findings that the Commission has not made here.

Finally, in Sections VIII. through X., we address numerous practical concerns with the substantive provisions of the Proposal and its impact, including: the "crowding-out" provisions, the cap on the new

[2] "Excessive Speculation and Position: Limits in Energy Derivatives Markets", CME Group White Paper (July 21, 2009).

financial risk management exemption for swap dealers, the absence of an exemption for index and exchange-traded funds, and the absence of the independent controller exemption on aggregation of positions. We also raise concerns that, with respect to Significant Price Discovery Contracts ("SPDCs") traded on Exempt Commercial Markets ("ECMs"), the Proposal does not change the current status quo under which uncleared SPDCs continue to remain unregulated and are not subject to any manner of position limits, position reporting or other regulatory oversight. This is the case even though the CFTC already has statutory authority to impose position limits on such uncleared SPDC contracts. Thus, the Proposal would provide a continuing incentive to utilize the existing loophole applicable to the less transparent trading activity in SPDCs on an ECM. In addition, the section on cost-benefit analysis in the Proposal is incomplete and seriously understates the negative impact that will occur on regulated futures markets should the Proposal be implemented in its current form.

These restrictions and the Proposal's problematic approach to exemptions threaten to further drive activity away from regulated and transparent markets regulated by the Commission and into products available in the OTC markets and on foreign boards of trade that are not regulated by the Commission. Such a shift, which has already begun, would damage the important public benefits offered by the regulated markets, by reducing liquidity, price transparency and the broad availability of information to regulators and the public. These unintended consequences are exactly counter to the policy objectives that Congress is pursuing. The effects of the Proposal clearly undermine the Administration's and Congress' stated goals of enhancing transparent markets and central counterparty clearing.

Congress is currently considering very substantial and broad-based amendments to the statutes governing financial services regulation. These changes are expected to alter and expand the Commission's authority over the OTC markets and codify the CFTC's authority over foreign boards of trade seeking to provide direct electronic access to U.S. markets. While we continue to believe that the Proposal does not satisfy the requirements established by the CEA, and that the facts do not support a conclusion that the proposed position limits would benefit the markets, as noted, we urge the Commission, at the very least, to delay further action on the Proposal until the legislative process is completed. Once Congress has completed the legislative process, the Commission will be in a better position to evaluate and address impacts across related futures and OTC markets.

II. The Proposal is Premature and Absent Additional CFTC Authority Would Result in Further Acceleration of the Shift in Liquidity Already Underway from CFTC-Regulated Markets

By last fall, the CFTC, in the view of many, had created the impression that it intended to impose a stringent position limit regime and curtail participation by swap dealers and index funds in the futures markets for energy products. As a result, that perception has already influenced multiple funds to change their investment decisions, reducing their use of U.S. futures products.[3] Moreover, the adverse impact on

[3] The following are illustrative examples of this clear trend:

U.S. futures markets has continued and deepened as our market participants began to shift from use of the NYMEX futures contracts to other alternatives that are anticipated to be subject to less restrictive regulation.

III. The Imposition of Federal Position Limits by the CFTC is Contrary to the CEA's Statutory Structure and the CFTC's Established Regulatory Practice.

A. The CEA and the CFTC's Prior Course of Dealing Reflect Congressional Acknowledgment that Limits Were to be Set by the Exchanges

Section 4a(a) of the Act authorizes the Commission to impose daily trading limits and speculative position limits for the purpose of "diminishing, eliminating or preventing" the burdens of "excessive speculation."[4] Pursuant to this authority, the Commission historically has set speculative position limits for some but not all of the enumerated agricultural commodities. With respect to all other commodities, however, the Commission has delegated the authority to set position limits to designated contract

---

1. **Deutsche Bank and Gresham No Action Letters**. On August 19, 2009, the CFTC withdrew long-standing no-action letters to DB and Gresham Investment Management, re-imposing speculative position limits for soybeans, corn and wheat on their index products. Consequently, both firms needed to reduce their positions in CME's fully-regulated agricultural contracts to comply with the change. DB announced it would shift positions to the Euronext-Paris milling wheat contract.

2. **United States Natural Gas Fund Reductions**. In August 2009, this natural gas ETF temporarily stopped issuing new units "due to current and anticipated new regulatory restrictions and limitations." UNG began offering new units on a limited basis, following a rebalancing that shifted 20 to 25% of its futures positions into OTC natural gas total return swaps.

3. **US Fund Company to Start Foreign Crude Fund**. In September 2009, United States Commodity Funds LLC announced that it would launch an ETF based upon Brent Crude Oil, the European benchmark crude oil product. Before now, this company's crude oil ETFs have been based upon the more liquid WTI crude oil futures markets.

4. **Deutsche Bank Rebalances Commodity Funds in Favor of Foreign Markets**. In September 2009, Deutsche Bank announced a rebalancing of two commodity funds that would begin shifting positions from CME's US markets to Intercontinental Exchange's UK-regulated futures markets.

5. **Standard & Poor's Accelerates Foreign Commodity Index**. In September 2009, S&P announced that it would accelerate the launch of a new index based on non-US commodities. Although S&P previously expressed concerns about the low liquidity in foreign markets, it has renewed its efforts to establish a credible index because of demand from US-based customers concerned about pending regulatory impact on US markets.

6. **Thomson Reuters / Jeffries Group Launches Commodity Stock ETF**. In an effort to offer investors an opportunity to invest in commodities markets (without using commodity futures), investment bank Jeffries launched an ETF based on 147 common stocks of companies involved in agriculture, metals and energy.

[4] 7 U.S.C. §6a(a).

markets based on a recognition that exchanges have the expertise and are in the best position to set position limits for their contracts. Additionally, exchanges are obligated to set appropriate limits in order to comply with their self-regulatory responsibility to maintain orderly markets. The Commission's direct use of the authority conferred in Section 4a(a) is neither required nor justified if the relevant designated contract market has acted effectively to avoid "excessive speculation...."

The delegation of authority to exchanges took place in 1981, when the Commission adopted former Regulation 1.61, which required exchanges to impose speculative position limits.[5] Since 1981, Congress has repeatedly reexamined the statutory structure and ongoing regulatory practice during the CEA reauthorization process. Consequently, Congress understands and intends for the exchanges to have authority and responsibility to set position limits in the first instance with respect to the non-enumerated agricultural commodities, including energy contracts, under the CEA.

In setting forth its reasoning for requiring exchanges to take such action, the Commission emphasized that Section 4a(a) "should not be read in a vacuum," explaining that when the CEA "is read as a whole, it is apparent that Congress envisioned cooperative efforts between the self-regulatory organizations and the Commission. Thus, the exchanges, as well as the Commission, have a continuing responsibility in this matter under the Act."[6] The Commission went on to note that former Regulation 1.61 "merely effectuates completion of a regulatory philosophy the industry and the Commission appear to share," referencing the fact that the exchanges had already been imposing position limits on certain contracts.[7]

To ensure that no doubt remained as to the exchanges' role with respect to speculative position limits, the Commission further explained that CEA Section 8a (7)[8] "underscores the fact that Congress affirmatively contemplated a regulatory system **whereby the exchanges would act in the first instance** to adopt rules which would protect persons producing, handling, processing or consuming any commodity traded for future delivery."[9] Consistent with this approach, the Commission fashioned former Regulation 1.61 to assure that the exchanges would have an opportunity to employ their knowledge of their individual contracts to propose the position limits they believe most appropriate.[10]

---

[5] 46 Fed. Reg. 50939.
[6] Id.
[7] Id. at 50940.
[8] Section 8a(7) of the CEA provides that the Commission is authorized:

> to alter or supplement the rules of a registered entity insofar as necessary or appropriate by rule or regulation or by order, if after making the appropriate request in writing to a registered entity that such registered entity effect on its own behalf specified changes in its rules and practices, and after appropriate notice and opportunity for hearing, the Commission determines that such registered entity has not made the changes so required, and that such changes are necessary or appropriate for the protection of persons producing, handling, processing, or consuming any commodity traded for future delivery on such registered entity, or the product or byproduct thereof, or for the protection of traders or to insure fair dealing in commodities traded for future delivery on such registered entity. 7 U.S.C. §12a(7).

[9] 46 Fed. Reg. 50938, 50940 (emphasis supplied.)
[10] Id.

With the adoption of former Regulation 1.61, the regulatory structure for speculative position limits was administered under a two-pronged framework, resulting in enforcement of speculative position limits being shared by both the Commission and the DCMs.[11] The Commission staff explained the parameters of this framework in its 2008 Staff Report:

> Under the first prong, the Commission establishes and enforces speculative position limits for futures contracts on a limited group of agricultural commodities. These "Federal limits" are enumerated in Commission regulation 150.2, and apply to the following futures and option markets: CBOT corn, oats, soybeans, wheat, soybean oil, and soybean meal; Minneapolis Grain Exchange (MGX) hard red spring wheat and white wheat; ICE Futures U.S. (formerly the New York Board of Trade) cotton No. 2; and Kansas City Board of Trade (KCBT) hard winter wheat.
>
> Under the second prong, for all other commodities, individual DCMs, pursuant to the core principles under the Act, establish and enforce their own speculative position limits or position accountability provisions (including exemption and aggregation rules), subject to Commission oversight and separate Commission authority to enforce exchange-set speculative position limits as violations of the Act. <u>Thus, responsibility for enforcement of speculative position limits is shared by the Commission and the DCMs.</u>[12] (emphasis supplied).

The Staff Report also discussed the Futures Trading Act of 1982, which added new section 4a(e) to the Act and confirmed that this statutory section "acknowledged <u>the key role of exchanges in setting their own speculative position limits</u>, by providing that —[n]othing in [section 4a] shall prohibit or impair the adoption] of exchange speculative position limits." [13] (emphasis supplied.)

In 1999, the Commission simplified and reorganized its rules by relocating the substance of Regulation 1.61's requirements to Part 150 of the Commission's regulations, thereby incorporating within Part 150 provisions for both Federal speculative position limits and exchange-set speculative position limits.[14] With the passage of the Commodity Futures Modernization Act ("CFMA") in 2000 and the Commission's subsequent adoption of its Part 38 regulations covering DCMs in 2001, Part 150's approach to exchange-set speculative position limits was incorporated as an acceptable practice under DCM Core Principle 5 – Position Limitations or Accountability.[15]

Core Principle 5 requires exchanges to adopt position limits or position accountability — by bylaw, rule or regulation — where necessary and appropriate, and the Commission, in evaluating a

---

[11] The Commission has consistently endorsed this framework when addressing issues related to speculative limits. See, e.g., 74 Fed. Reg. 12282; 72 Fed. Reg. 66097; 70 Fed. Reg. 12621; 69 Fed. Reg. 33874.
[12] Commodity Futures Trading Commission, Commodity Swap Dealers & Index Traders with Commission Recommendations, (Sept. 11, 2008) (hereafter, "Staff Report"), available at http://www.cftc.gov/stellent/groups/public/@newsroom/documents/file/cftcstaffreportonswapdealers 09.pdf., at 42.
[13] 2008 Report at 41.
[14] Id.
[15] Id.

contract market's speculative limit program, considers the specific limit levels, aggregation policies, the types of exemptions allowed, and the methods for monitoring and enforcing compliance with the limits. See Appendix B to Part 38 ("In order to diminish potential problems arising from **excessively large speculative positions**, and to facilitate orderly liquidation of expiring futures contracts, markets may need to set limits on trader positions for certain commodities.) (emphasis supplied.)

The Commission's Core Principles further provide that "position limits are not needed for markets where the threat of market manipulation is non-existent or very low," such as for contracts on major foreign currencies and other financial commodities that have highly liquid and deep underlying cash markets, and that "a contract market may impose position accountability provisions in lieu of position limits for contracts on financial instruments, intangible commodities, or certain tangible commodities, which have large open interest, high daily trading volumes, and liquid cash markets."[16]

B. Federal Position Limits are Not Necessary Because Futures Exchanges Maintain Effective Market Surveillance Programs to Prevent Excessive Speculation

The current framework with respect to position limits and exemption from such limits established by the CEA and currently implemented by the Commission and the exchanges is effective. The Commission should continue to allow each exchange, subject to Commission oversight of its compliance with DCM Core Principles, to establish rules consistent with the objectives of reducing the potential threat of market manipulation or problems arising from excessively large speculative positions. We believe that an exchange is best suited to police activity in its market, set position limits and assess whether a hedge exemption is appropriately granted to a particular customer. This approach is recognized by the CEA and the Commission's Regulations and past practices.

In the Proposal, the CFTC asserted that "(a)lthough regulation 1.61 directed the exchanges to implement position limit rules, the pre-CFMA exchange rule approval process, on a practical level, gave the Commission the ability to shape the requirements of exchange-set position limit rules as measures that guarded against excessive speculation...."[17] During the CFTC's energy hearings last July, Chairman Gensler further commented that DCM Core Principle 5 as it became law in 2000 and as it stands today by its terms referred to reducing the "potential threat of market manipulation or congestion" and thus did not appear to establish a statutory obligation on exchanges to maintain programs designed specifically to address excessive speculation.[18]

[16] See Part 38, Appendix B, Core Principle 5(b)(2)-(3). As a note, in our experience, on a practical level, the core principles regulatory structure and the certification process, including in particular rule changes involving position limits or position accountability levels, have worked extremely well. Exchange staff routinely engages in numerous and detailed consultations with CFTC staff prior to undertaking to implement any rule changes in these areas. The core principles structure and the certification process are widely acknowledged throughout the industry for their positive contributions to a vigorous and effective CFTC regulatory regime.

[17] 75 Fed. Reg. 4144, 4146.

[18] Transcript of July 28, 2009 Hearing, at page 70.

Yet, the very first sentence of the acceptable practices guidance on this Core Principle expressly refers to diminishing "potential problems arising from excessively large speculative positions".[19] Indeed, this very point was also made by the CME Group during those hearings last year.[20] Moreover, in our experience, CFTC staff has long provided guidance on both excessive speculation and manipulation concerns in the context of reviewing exchange rules and programs concerning position limits and position accountability levels. This guidance did not change or abate as a result of implementation of the CFMA's core principles structure and rule and contract certification process.

We aggressively monitor both for excessive speculation as well as for manipulation and attempted manipulation. Maintaining the integrity of our markets against manipulation is one of the core missions of our self-regulatory program and deterring and preventing price manipulation is listed first in the list of core purposes of the Act. But it is necessary to clarify that manipulation is not the same as excessive speculation, and some of the public (and even policy) discussions in recent years have appeared to confuse or conflate these two activities.

At the CME Group, our practice consistently has been to consult closely with Commission staff before initiating any changes to our exchange rules concerning limits in our energy complex. The CME Group Exchanges take their responsibilities under the Core Principles seriously.[21] The Exchanges face both financial and reputational risk if one of their markets were the target of a successful manipulation, unwarranted price movements or volatility caused by "excessive speculation" or if their customers became the target of fraud or other abuse.

With respect to contracts in energy commodities, the Acceptable Practices for Core Principle 5 specifically provide that exchanges do not need to adopt position limits.[22] Moreover, the Acceptable Practices specifically provide that exchanges may provide for position accountability provisions in lieu of position limits for contracts in markets with large open-interest, high daily trading volumes and liquid cash markets. Furthermore, with respect to spot-month limits, the Acceptable Practices provide that the level of the spot limit for physical-delivery markets should be based upon an analysis of deliverable supplies and the history of spot-month liquidations and that such limits are appropriately set at no more than 25 percent of the estimated deliverable supply. For cash-settled markets, spot-month position limits may be necessary if the underlying cash market is small or illiquid such that traders can disrupt the cash market

[19] See Appendix B to Part 38.
[20] Transcript of July 28, 2009 Hearing, at page 99. Mr. Donohue commented at the hearing that the Commission's own interpretation of acceptable practices clearly places the obligation of policing against excessive speculation on exchanges.
[21] Based on a comparison with data that we made public in 2009, we have 145 employees, including dedicated developers for regulatory systems, who work on Market Regulation duties (as well as another 58 employees dedicated to audits). We have 40 staffers dedicated to market surveillance. The annual direct cost of maintaining this self-regulatory program is over $30 million, with an additional $5-7 million in regulatory technology support as well as indirect support from other departments, including the Research and Legal Departments.

[22] *See,* Acceptable Practices (2), "Thus, contract markets do not need to adopt speculative position limits for futures markets on major foreign currencies, contracts based on certain financial instruments having very liquid and deep underlying cash markets, and contracts specifying cash settlement where the potential for distortion of such price is negligible."

or otherwise influence the cash-settlement price to profit on a futures position. Finally, the Acceptable Practices provide that markets may elect not to provide all-months-combined and non-spot month limits.

The existing regime at NYMEX in its energy markets fully complies with the CEA and the Commission's' Regulations.[23] We employ position limits in our energy complex during the last three business days of trading and generally utilize position accountability levels at other times to avoid congestion and other market disrupting events that may flow from excessive concentrations of positions. Nothing we have heard or read discredits the principles on which that policy was built.

With regard to position limits in the last three days of trading, exemptions may be granted by the exchange for bona fide hedgers based on physical or swap exposure. Firms wishing to exceed the position limits must file a hedge notice and obtain the approval of the Exchange. The applicant must provide acceptable documentation that the positions to be held are bona fide hedge positions by providing the company's current, historical, or anticipated exposure in the physical or swap markets, as well as any supplemental information the exchange may require.

In granting hedge exemptions the exchange considers the following criteria: 1) physical hedge or swap exposure; 2) financial condition and stability of the company; 3) market liquidity; 4) trading history of the company; and 5) internal procedures and controls suitable to oversee the position. The exchange may elect to revoke the hedge exemption in the event the company is unable to meet the above requirements, or if market factors change. Firms exceeding the limits that are unable to demonstrate physical or derivative exposure are in violation of position limit rules and subject themselves and possibly their clearing firms to disciplinary action. A hard copy summary sheet of all exemptions is regularly and routinely filed with CFTC's Division of Market Oversight ("DMO") in New York. This procedure has been in place for many years.

Position accountability provisions provide a formal means for an exchange to monitor traders' positions that may threaten orderly trading. A position accountability approach establishes threshold position levels that may be exceeded, but once a trader breaches such accountability levels, the exchange may initiate an inquiry to examine the trader, the rationale for holding the position and whether the position poses a threat of manipulation or could otherwise be disruptive to the market. A position accountability regime also allows exchange regulatory staff to order a trader with a position in excess of

---

[23] Commission Regulation 150.5, which as noted provides guidance on acceptable practices for Core Principle 5, addresses position limits and accountability limits. In relevant part, Commission Regulation 150.5 provides:

> For futures and option contracts on a tangible commodity, including but not limited to `, energy products, or international soft agricultural products, having an average month-end open interest of 50,000 contracts and an average daily volume of 5,000 contracts and a liquid cash market, an exchange bylaw, regulation or resolution requiring traders to provide information about their position upon request by the exchange and to consent to halt increasing further a trader's positions if so ordered by the exchange, *provided, however,* such contract markets are not exempt from the requirement of paragraphs (b) or (c) that they adopt an exchange bylaw, regulation or resolution setting a spot month speculative position limit with a level no greater than one quarter of the estimated spot month deliverable supply.

accountability levels not to further increase or to reduce his position where it is deemed appropriate.[24] A failure to comply with a directive to either maintain or reduce a position is deemed a rule violation.

Our administration of accountability levels in the energy complex is routinely scrutinized in our rule enforcement review by DMO staff and has always been found to be in compliance with the Core Principles and applicable regulations. The CME Exchanges set accountability levels low to obtain an early alert within our Large Trader System and to maximize the scope of our regulatory authority. In fact, we recently lowered accountability levels in our metals and core energy contracts and expanded the scrutiny we apply to a participant's position on a futures-only basis as well as a futures-equivalent basis. This point is often missed by those who tally the number of instances that a position accountability level is triggered at an exchange as some form of demonstration that position accountability levels are not effectual in serving their intended role. They are indeed effective for their designed purpose. These critics also fail to take into account that the extent to which position accountability levels are exceeded generally constitutes only a small fraction of the applicable open interest. It is well-understood in the industry and among CFTC staff that traders can and do hold positions in excess of the accountability levels without adversely impacting prices or volatility.

Moreover, we create and maintain a weekly report of all participants that exceed NYMEX Position Accountability Levels in all core contracts, through which analysts and Market Surveillance management make real time decisions on actions to be taken respecting market participants' positions. For each customer exceeding Accountability Levels, an Exchange analyst will prepare a recommendation for the management of Market Surveillance regarding a recommended course of action. Such recommendations are made in light of the following factors:

- Type of customer/nature of customer's business (i.e., individual/corporation, speculator /hedger);
- Percent of open interest the customer's position represents;
- The customers total book;
- Relationship/comparison of the customer's position to other customers;
- If the customer maintains an exemption, the comparison of the customer's position with other customers maintaining a hedge exemption; and
- Changes in the position from week-to-week

After consultation with Market Regulation senior staff, the analyst (in conjunction with other Market Surveillance staff as necessary) would take appropriate action, including:

---

[24] Exchange Rule 560 was recently amended to allow an Exchange's Chief Regulatory Officer additional flexibility to order a reduction of positions above accountability levels or above position limits (pursuant to a hedge exemption) at his discretion.

- Obtaining additional information relating to the position (i.e., nature, trading strategy employed, financial wherewithal of customer, etc.);

- Instructing the customer to freeze or to partially liquidate its position;

- Approving conditionally with continued scrutiny and scheduled follow up review date;

- Requiring compliance with a prospective limit above the current position or limiting the size of the position as a percentage of open interest; or

- Continuing to monitor positions.

Between January 2009 and February 2010, NYMEX took 35 such actions to require market participants either to maintain (with no additional increases allowable) or to engage in an outright reduction of their positions in the energy complex. Additionally, the Surveillance staff monitors deliverable supplies in order to anticipate potential congestion or delivery problems.

Moreover, as noted, CFTC Rule Enforcement Reviews have included position accountability level reviews and have affirmatively concluded that when accountability levels are reached, NYMEX responds promptly, almost always on the same day, by contacting the customer to obtain required information and take appropriate additional action when warranted. For example, in the most recent rule enforcement review of NYMEX's market surveillance program, CFTC staff found that Exchange staff "made appropriate and timely decisions regarding responsive action."[25]

The current framework with respect to position limits and exemption from such limits established by the CEA and currently implemented by the Commission and the exchanges is effective. Consequently, the Commission should continue to allow each exchange, subject to Commission oversight of its compliance with DCM Core Principles, to establish rules consistent with the objectives of reducing the potential threat of market manipulation or problems arising from excessively large speculative positions.

We note that the FIA in its comment letter makes the point that the "blunt instrument" of position limits is not suitable in dynamic, ever-changing energy markets to address across-the-board the threat to market prices that concentrations may pose in certain limited circumstances. We agree with the FIA's view. In general, our experience has been that the combination of aggressive accountability levels and vigilant market surveillance actually serve as far more effective tools to address excessive concentrations than rigid limits.

[25] CFTC Division of Market Oversight, Market Surveillance Review Rule Enforcement Review of the New York Mercantile Exchange, May 19, 2008, p. 40.

IV. Imposition of Federal Position Limits Under the CEA Requires an Affirmative Finding that Federal Position Limits are "Necessary"

Section 4a(a) in pertinent part provides as follows:

> Excessive speculation in any commodity under contracts of sale of such commodity for future delivery made on or subject to the rules of contract markets or derivatives transaction execution facilities, or on electronic trading facilities with respect to a significant price discovery contract causing sudden or unreasonable fluctuations or unwarranted changes in the price of such commodity, is an undue and unnecessary burden on interstate commerce in such commodity. **For the purpose of diminishing, eliminating, or preventing such burden**, the Commission shall, from time to time, **after due notice and opportunity for hearing**, by rule, regulation, or order, proclaim and fix such limits on the amounts of trading which may be done or positions which may be held by any person under contracts of sale of such commodity for future delivery on or subject to the rules of any contract market or derivatives transaction execution facility, or on an electronic trading facility with respect to a significant price discovery contract, **as the Commission finds are necessary to diminish, eliminate, or prevent such burden**. (emphasis supplied).

In a statement by CFTC Chairman Gary Gensler included in the Proposal, he commented that "[t]he CFTC is directed in its original 1936 statute to set position limits to protect against the burdens of excessive speculation, including those caused by large concentrated positions. In that law – the Commodity Exchange Act (CEA) – Congress said that the CFTC 'shall' impose limits as necessary to eliminate, diminish or prevent the undue burden that may come as a result of excessive speculation. We are directed by statute to act in this regard to protect the public."[26] Similarly, in footnote 13, a key footnote in the Proposal, the CFTC states that:

> "Requiring a specific demonstration of the need for position limits is contrary to section 4a(a) of the Act, which provides that the Commission shall set position limits from time to time, among other things, to prevent excessive speculation."[27]

This is contrary to the plain language of Section 4a(a). While Section 4a(a) provides that the CFTC "shall, from time to time" fix and proclaim limits, the Commission is only authorized to do so insofar "**as the Commission finds are necessary** to **diminish, eliminate or prevent such burden** [of excessive speculation]." (emphasis supplied.) Aside from the assertion contained in footnote 13, the Commission does not otherwise provide any basis of support for this interpretation of the Act.

In this regard, during the first day of the CFTC's three days of hearings on position limits for energy commodities last July. Dan Berkovitz, CFTC General Counsel, addressed this specific point. Chairman Gensler asked the following question:

---

[26] 75 Fed Reg. 4144, at 4169.
[27] 75 Fed Reg. 4144, at 4146.

"What does the word shall mean in 4(a)? There's a word that the Commission shall set."[28]

In response, Mr. Berkovitz replied as follows:

> "**If the Commission finds that position limits are necessary** to prevent, diminish or eliminate such burdens, then there is a directive that it shall establish position limits." [29] (emphasis supplied.)

We believe that the CFTC's General Counsel confirmed correctly in his response that the CFTC's authority to set position limits is conditional upon first making a finding that such limits are necessary. This interpretation provided during last year's hearings is also consistent with longstanding CFTC interpretation of this section. Indeed, preceding even the creation of the CFTC in 1974, no federal regulatory agency since 1936 has interpreted Section 4a(a) to mandate any new Federal position limits (beyond those already established for certain of the enumerated agricultural commodities) or permit the imposition of limits absent such a finding.[30]

As a federal agency, the CFTC only has such powers and authority as have been vested with the agency by Congress under its governing statute. In the absence of any economic evidence regarding the existence of excessive speculation or its impact on futures markets, it is quite difficult and perhaps even impossible for the CFTC to reach the necessary finding required under the Act. But that difficulty does not mean the CFTC is able to avoid or evade a clear affirmative obligation imposed by statute. If the CFTC seeks to establish new Federal position limits, such as for energy products, it must first comply with the statute.[31]

V. The Proposal to Establish Federal Position Limits in Energy Products Would Violate the CEA and Procedural Requirements under the Administrative Procedures Act

As described above, the CFTC has not made any attempt to make a finding or otherwise provide any level of support regarding the current existence of excessive speculation or a finding that the Proposal would "diminish" or "eliminate" current levels of excessive speculation (if it found that such levels did exist). While the CFTC did hold three days of public hearings last year on energy markets and on the possible imposition of Federally set position limits, it did not issue any findings as a result of those

---

[28] Transcript of July 28, 2009 CFTC Hearing on Energy Position Limits, pp. 35-36.
[29] Transcript of July 28, 2009 Hearing at page 36.
[30] As noted in the FIA's March 18, 2010 comment letter on the Proposal, Section 4a(a) expressly authorizes federally-imposed daily trading limits for speculators, which were in place for many years. However, in 1979, the CFTC repealed the daily trading limits after finding they were no longer "necessary." 44 Fed. Reg. 7124 (1979).

[31] In all cases involving statutory construction, the starting point must be the language employed by Congress and courts may assume that the legislative purpose is expressed by the ordinary meaning of the words used. American Tobacco Co. v. Patterson, 456 U.S. 63 (1982). A statute should be interpreted so as not to render one part inoperative. Mountain States Tel. & Tel. v. Pueblo of Santa Ana, 472 U.S. 237 (1985). A court must, if possible, give effect to every clause and word of a statute. Negonsott v. Samuels, 507 U.S. 99 (1993).

hearings. Indeed, to date, the closest statement to a finding regarding excessive speculation would seem to be the findings in the 2008 Staff Report. In that report, the CFTC staff made several findings concerning energy markets that supported the conclusion that speculators were not in fact impacting those markets.

The CFTC instead is engaged in anticipatory regulation and is aiming only to "prevent such burden" (of excessive speculation) from occurring in the future. However, even in this limited application, Section 4a(a) nonetheless requires that the CFTC can fix such limits only after it affirmatively "finds" that such limits are "necessary" to prevent the burden of excessive speculation.[32] Absent such a finding, there is not a substantive basis under the CEA for the CFTC to establish and fix position limits. Even with respect to a finding concerning preventing future occurrences of excessive speculation, as detailed below in Section VI. Below, we do not believe that it is possible to make such a finding in view of the research and economic data that are currently available.

The CFTC states that it seeks to prospectively prevent excessive speculation in the markets by reducing the concentration of large traders in the markets through the imposition of the position limits and limitations on the speculative activity of certain market participants. However, there is no statutory basis under the CEA for the CFTC to adopt rules for the purpose of restricting "concentration" of positions. The Proposal focuses upon undue concentration of positions, but the Proposal does not provide any evidence that the current concentration of positions has harmed or had any impact on the market for the referenced energy commodities. Consequently, the Proposal does not provide any data or information to justify the focus on concentration. The Proposal also does not describe any unique harm applicable to concentrations of speculative positions that might thus be addressed by limits on speculative positions. Without a showing demonstrating how concentrations of speculative positions would be more harmful and thus would have a greater impact on price than concentrations of hedge positions, the CFTC simply cannot assert that the proposed limits on speculation are "necessary" to prevent the alleged harms arising from concentrations in speculative positions. In other words, the perceived harms could occur even subsequent to the implementation of limits on speculative positions if concentrations of other large positions, such as concentrations of hedge positions, likewise were reduced in a disorderly manner.

Turning to procedural requirements, notice and comment is a central feature of the Administrative Procedures Act ("APA"). Where properly followed, it allows the public an opportunity to participate in the rulemaking process and further allows the federal agency the opportunity to receive comments that may highlight issues or problems that were not considered by the agency. However, the Proposal is devoid of any commentary concerning the CFTC's own findings of excessive speculation, its views and analysis on the necessity for such limits, the nature of excessive speculation or of the burdens caused by excessive speculation. The APA requires that notice of a proposed rule include "sufficient detail on its content and

---

[32] We note that although the Proposal includes a question seeking comment on whether position limits are necessary, the question is worded to refer to addressing "position concentrations", which is not part of the affirmative showing to be made under this statutory requirement.

basis in law and evidence to allow for meaningful and informed comment."[33] But in the Proposal, the public has not been provided an adequate opportunity to comment on the necessity for a finding. Thus, as detailed at length in the FIA's March 18, 2010 comment letter, the Proposal is inconsistent both with applicable case law under the APA as well as with the CFTC's own historical practice.

We do not support the Proposal and we do not believe that that Federal limits on energy commodities are necessary. That stated, from the perspective of the Commission's compliance with its statutory obligations, we believe that the CFTC would need either to define excessive speculation or provide some clear explanation of the circumstances that would demonstrate excessive speculation.[34] Even, as is the case with the Proposal, where the CFTC is focusing only upon preventing excessive speculation on a going forward basis, the Commission still must demonstrate how the imposition of Federal position limits would specifically "prevent" the burden of excessive speculation and further show why each aspect of its proposed approach is "necessary" in preventing such a burden. This demonstration was not provided in the Proposal.

Equally fundamentally, in the Proposal, the Commission asserts that Section 4a reflects a congressional mandate providing the CFTC "with responsibility for setting contract position limits in any commodity to prevent or minimize extreme or abrupt price movements **resulting from large or concentrated positions**." (emphasis supplied.)[35] However, this mandate concerning concentrated positions does not appear anywhere in the Act. In addition, we note that the CFTC does not provide any legislative history, precedent or other basis for establishing any such authority referring specifically to concentrated positions.

---

[33] *American Medical Association v. Reno*, 57 F.3d 1129, 1132 (D.C. Cir. 1995). *See e.g. Chamber of Commerce v. SEC*, 443 F.3d 890 (D.C. Cir. 2006); *Engine Mfrs. Ass'n v. EPA*, 20 F.3d 1177 (D.C. Cir. 2004). An agency initiating a comment period must provide "sufficient factual detail and rationale for the rule to permit interested parties to comment meaningfully. Florida Power and Light Co. v. Unites States, 846 F.2d 765, 771 (D.C. Cir. 1988). "The most critical factual material that is used to support the agency's position on review must have been made public in the proceeding and exposed to refutation." Association of Data Processing Serv Orgs v. Bd. Of Governor of the Federal Reserve Sys., 745 F.2d 677, 684 (D.C. Cir. 1984).

[34] In the Proposal, the CFTC notes that commodity prices generally and energy prices specifically increased significantly and experienced "unusual" volatility from 2007 to mid 2008. However, it is a noticeable leap to move from volatility that is merely "unusual" to price changes that are "unreasonable" or "unwarranted" as provided by Section 4a(a).

In this connection, during the CFTC's energy hearings, Commissioner Dunn commented that:

> "Instead of defining excessive speculation and preemptively addressing any impact it may have on the futures markets, Congress and the Commission have chosen to react to market events that may or may not be caused by excessive speculation. This is akin to treating a symptom of an illness without diagnosing the disease and finding a cure." Transcript of July 28, 2009 Hearing at page 12.

We agree.

[35] 75 Fed Reg. 4144, at 4148.

VI. Federal Position Limits are Not "Necessary" Because There is an Absence of Credible Empirical Support for Assertions About the Existence of Excessive Speculation or its Likely Future Occurrence

After a careful review of the publicly available analysis and research, we strongly believe that a credible case establishing either the existence of excessive speculation or its likely future occurrence has yet to be made to date in any public forum, and we have not seen any evidence that would support such a finding. Moreover, although Section 4a refers to speculation that causes prices to fluctuate unreasonably or change in an unwarranted manner, price volatility is an inherent aspect of futures contracts, as markets respond instantaneously to new information concerning supply and demand fundamentals. Although prices may fluctuate rapidly, such fluctuation does not necessarily mean that the price changes are unreasonable or unwarranted.

A. Overview of Academic Research

Virtually every competent economist who has looked at real data, rather than anecdotes, and who has applied legitimate economic analysis concludes that neither speculators, swap dealers nor index funds are distorting commodity prices. Contrary to the assertion that speculators are uniformly on the buy side and are pushing prices up on that basis, the publicly available data has been relatively consistent over time in demonstrating that speculators in crude oil futures contracts have been relatively balanced as between buy and sell positions in the market. Thus, for example, *The Wall Street Journal* surveyed a significant cross section of economists who agreed that: "[t]he global surge in food and energy prices is being driven primarily by fundamental market conditions, rather than an investment bubble . . .."[36]

The weight of the evidence and informed opinion confirms that the high prices observed two years ago were a consequence of supply and demand factors external to speculative trading and the hedging of swap dealers and index funds on futures exchanges. Thus, for example, a review of the United States Oil Fund, L.P.'s open positions shows that it was liquidating (selling) positions while oil prices were rising and taking (buying) additional positions when oil prices were falling (again contradicting common expectations).[37]

---

[36] *See* Phil Izzo, Bubble Isn't Big Factor in Inflation, WALL ST. J., May 9, 2008, at A2. See also Philip C. Abbott, Christopher Hurt, Wallace E. Tyner, "What's Driving Food Prices," Farm Foundation, Issue Report (March 2009 Update); Ronald Trostle , "Global Agricultural Supply and Demand: Factors Contributing to the Recent Increase in Food Commodity Prices," A Report from the Economic Research Service of the USDA (July 2008); and Ennis Knupp & Associates, "The Role of Institutional Investors in Rising Commodity Prices" (June 2008). U.S. Government Accountability Office, Issues Involving the Use of the Futures Markets to Invest in Commodity Indexes, (Jan. 30, 2009), available at http://www.gao.gov/new.items/d09285r.pdf , which analyzed the available data respecting any causal relationship between speculation and commodity prices and concluded that the eight empirical studies reviewed "generally found limited statistical evidence of a causal relationship between speculation in the futures markets and changes in commodity prices – regardless of whether the studies focused on index traders, specifically, or speculators, generally." GAO Report at page 5.

[37] Specifically, in a July 6, 2009 Form 8K filing made by the U.S. Oil Fund to the Securities and Exchange Commission, the U.S. Oil Fund submitted a chart and data that compared the price of the NYMEX front month light,

B. Studies by CFTC Staff

Under Section 3 of the Act ("Protection of the Public Interest"), the CFTC's statutory mission includes fostering effective price discovery and detecting and deterring manipulation and attempted manipulation of futures markets. Consequently, the CFTC as an agency has placed substantial emphasis upon, and has developed significant expertise concerning, economic research and economic analysis of futures and derivatives markets. This is significant because the prior work of CFTC staff has reached consistent results to those of academic and private sector economists.

Utilizing the CFTC's large trader database, in 2005, CFTC research staff reviewed the relationship between managed money traders ("MMTs") and other traders, including floor brokers, swap dealers, producers and manufacturers. The CFTC staff study found that on average MMTs do not change their positions as frequently as other participants, primarily hedgers. In addition, the staff also found that most of the MMTs position changes are triggered by hedging participants changing their positions. In other words, the price changes that prompt large hedgers to alter their positions in the very short run eventually will ripple through to MMT participants who will change their positions in response. Accordingly, the authors "find that MMTS are an important source of liquidity to the other participants and ... reject the hypothesis that MMT trading causes price volatility in U.S. futures markets."[38] As a note, a study undertaken by NYMEX research staff released in March 2005 reached similar results[39] and also

---

sweet crude oil contract ("CL") to the actual size of USO's crude oil futures contracts holdings. The time period covered by the chart ran from USO's inception date, April 10, 2006, to June 24, 2009. The data showed that "during the run-up in crude oil prices from January 2007 and $53 a barrel price, to July 2008 and roughly $145 a barrel, USO's holdings in crude oil futures contracts declined. Furthermore, the increase in crude oil contracts held by USO occurred in late 2008 and continued to February 2009, coinciding with a period of time when crude oil prices trended lower, not higher." This filing can be found in the SEC's EDGAR database at: http://sec.gov/Archives/edgar/data/1327068/000114420409035997/v153432_8k.htm. In other words, as discussed in a subsequent article, this fund was actually a net seller during the period when prices were increasing, and a net buyer during the period when prices were falling. "Oil ETF Provide Defends the Fund in Face of Criticism", Tom Lydon, etftrends.com (July 13, 2009).

[38] Haigh, Michael S; Hranaiova, Jana; Overdahl, Jim. "Price Volatility, Liquidity Provision and the Role of Managed Money Traders in Energy Futures Markets." U.S. Commodity Futures Trading Commission & Public Company Accounting Oversight Board (November 25, 2005).

[39] "A Review of Recent Hedge Fund Participation in NYMEX Natural Gas and Crude Oil Futures Markets" (March 1, 2005) (hereafter the "NYMEX Hedge Fund Study"). In that study, NYMEX staff examined data for 2004 and conducted regression analyses as well as a statistical Granger Causality test. For purposes of the NYMEX study, the Exchange determined to use an extremely broad scope of reference in analyzing trading activity in our markets. Thus, the trading activity reviewed to be referenced as "Hedge Fund" activity even included activity directed by commodity trading advisors. Following a careful review of data obtained from large trader reporting, NYMEX staff reached the following conclusions:

- Hedge Fund trading activity comprised a modest share of both trading volume and open interest in both crude oil and natural gas futures markets.
- Hedge Funds hold positions significantly longer than the rest of the market, which supports the conclusion that Hedge Funds are a non-disruptive source of liquidity to the market.
- With regard to price volatility in natural gas futures, when Hedge Fund activity alone is evaluated, the data strongly indicate that changes in Hedge Fund participation result in decreases in price volatility.

similarly concluded as to the value provided to commercial firms by non-commercial entities such as hedge funds.[40]

A follow-up study in 2007 by CFTC research staffers documents growth in NYMEX crude oil markets with specific attention to back-month trading. Based again on data from CFTC large trader database, this study concluded that the growing participation of commodity swap dealers had very beneficial market effects. In particular, growing market participation has had the effect of strengthening cointegration between nearby and distant crude oil futures, facilitating linkage between derivative and underlying markets and, in turn, enhancing price discovery and risk transference capacity of futures.[41]

The CFTC's 2008 Staff report, which was noted previously in Section III. contained a number of findings, including that index traders were reducing their positions in the OTC crude oil "futures equivalent" swap substitutes at the same time that the price was escalating. Indeed, the net reduction in the futures-equivalent swap positions constituted an 11% decline over the first six months of 2008.[42] The staff's analysis parallels the conclusions of many other economists who have also studied the issue of causation in the context of speculators and commodity futures prices, none of which has found a causal link between speculative trading and an increase in commodity prices. Furthermore, the preliminary assessment of the CFTC Inter-Agency Task Force on Commodity Markets is that fundamental supply and demand factors are the underlying cause of oil price volatility rather than speculators.[43]

- Even when Hedge Fund activity in natural gas futures is considered in connection with changes in inventory, the data indicate that changes in Hedge Fund participation appear to decrease price volatility.

[40] Specifically, the NYMEX Hedge Fund Study noted that:

> At any one point in time when a commercial firm submits an order to a futures market, there may or may not be other commercials submitting orders for the other side of the market. Accordingly, similar to floor traders, who are in the business of providing short-term liquidity to a market, Hedge Funds can serve to bridge the gap in liquidity at a point in time that may exist in the market between commercial participants who wish to buy and those who wish to sell. This intertemporal or "interstitial" liquidity is critically important to any futures market. NYMEX Hedge Fund Study at pp. 3-4.

[41] Haigh, Michael; Harris, Jeffrey H.; Overdahl, James A.; Robe, Michel A. "Market Growth, Trader Participation and Pricing in Energy Futures Markets." (February 7, 2007). In addition, a separate study undertaken by CFTC economists in 2007 found that hedge fund activity did not affect price levels in energy futures markets. Haigh, Michael S., Jana Hranaiova and James A. Overdahl, "Price Volatility, Liquidity Provision and the Role of Hedge Funds in Energy Futures Markets", Journal of Alternative Investments, Spring 2007.

[42] In the Proposal, the CFTC noted that "most relevant to the CFTC's proposed rulemaking" was the recommendation in the Staff Report regarding creation of a new limited risk management exemption for swap dealers and index traders. 75 Fed. Reg. 4144, 4151. However, the CFTC did not discuss or otherwise appear to take into consideration the numerous and significant findings of the 2008 Staff Report.

[43] Interagency Task Force on Commodity Markets, Interim Report on Crude Oil, Washington D.C. (July 2008) (hereafter "Interagency Report"). In the executive summary of the Interagency Report, the Task Force commented that "(i)f a group of market participants has systematically driven prices, detailed daily position data should show that that group's position changes preceded price changes. The Task Force's preliminary analysis, based on the evidence available to date, suggests that changes in futures market participation by speculators have not systematically preceded price changes. On the contrary, most speculative traders typically alter their positions following price changes, suggesting that they are responding to new information – just as one would expect in an efficiently operating market." Interagency Report, at page 3.

C. Reviews by Other Federal Agencies or Offices

Moreover, in the January 2009 Government Accountability Office report previously referenced in this comment letter as the GAO Report, the GAO analyzed the available data respecting any causal relationship between speculation and commodity prices generally. The GAO staff identified eight empirical studies and three qualitative studies analyzing the impact that index traders and other futures speculators have had on commodity prices. The GAO staff found that, unlike the empirical studies, the qualitative studies did not use experimental or statistical controls to evaluate the causal relationship between speculative trading and commodity prices and do not provide a systematic way to assess the empirical veracity of the causal relationship. Significantly, the eight empirical studies reviewed "generally found limited statistical evidence of a causal relationship between speculation in the futures markets and changes in commodity prices — regardless of whether the studies focused on index traders, specifically, or speculators, generally." The GAO Report effectively concurred with these studies.

The GAO went on to comment that "(i)n addition, all of the empirical studies we reviewed generally employed statistical techniques that were designed to detect a very weak or even spurious causal relationship between futures speculators and commodity prices. As result, the fact that the studies generally did not find statistical evidence of such a relationship appears to suggest that such trading is not significantly affecting commodity prices at the weekly or daily frequency."[44]

D. Reports by International Organizations

Turning to international reports, the International Monetary Fund's World Economic Outlook, published in October 2008, found that "there is little discernable evidence that the buildup of related financial positions [in commodity markets] has systematically driven either prices for individual

---

The Task Force is chaired by CFTC staff. As also noted in the Interagency Report, the CFTC created the Task Force by inviting staff from other agencies to participate in an ongoing review. The other Task Force participants include staff from the Departments of Agriculture, Energy and Treasury, the Board of Governors of the Federal Reserve System, the Federal Trade Commission, and the Securities and Exchange Commission.

Similarly, James Burkhard, managing director of Cambridge Energy Research Associates testified to the Senate Energy Committee on April 3, 2008 that:

> In a sufficiently liquid market, the number and value of trades is too large for speculators to unilaterally create and sustain a price trend, either up or down. The growing role of non-commercial investors can accentuate a given price trend, but the primary reasons for rising oil prices in recent years are rooted in the fundamentals of demand and supply, geopolitical risks, and rising industry costs. The decline in the value of the dollar has also played a role, particularly since the credit crisis first erupted last summer, when energy and other commodities became caught up in the upheaval in the global economy. To be sure, the balance between oil demand and supply is integral to oil price formation and will remain so. But 'new fundamentals'—new cost structures and global financial dynamics—are behind the momentum that pushed oil prices to record highs around $110 a barrel, ahead of the previous inflation-adjusted high of $103.59 set in April 1980.

[44] Id.

commodities or price formation more broadly."[45] A European Commission report concluded that the rise and fall of the price in oil in the recent past was due to supply and demand factors, with little or no evidence to suggest that speculators flooding the commodity markets caused price volatility.[46]

More recently, in March 2009, the Task Force on Commodity Futures Markets of the International Organization of Securities Commissions ("IOSCO"), co-chaired by the CFTC and the United Kingdom's Financial Services Authority, issued a report on the agricultural and energy commodities markets that found that economic fundamentals were the primary cause in the price volatility in the physical commodities markets during the summer of 2008, not speculative activity. Task Force on Commodity Futures Markets Final Report, Technical Committee of the International Organization of Securities Commission (March 2009).

E. Recent Academic Research

Finally, subsequent to the CFTC's hearings on energy markets in late July 2009, a number of studies have been released. For example, one study by scholars at Vanderbilt University undertook a "comprehensive evaluation of whether commodity index investing is a disruptive force not only in the wheat futures market in particular but in the commodity futures market in general.[47] The authors of that

---

[45] World Economic Outlook, International Monetary Fund (October 2008). The summary and conclusions concerning commodity prices are contained on pp. 116-122. Thus, for example, the IMF notes that the recent boom in commodity prices has largely been driven by the interaction of strong global growth, a lack of sector-specific spare capacity and low inventories from the onset of the boom, and slow supply responses. October 2008 Report, at pp. 116-117.

In Antoshin and Samiei's analysis of prior IMF research on the direction of the "causal arrow" between speculation and commodity prices in "Has Speculation Contributed to Higher Commodity Prices?" in World Economic Outlook (September 2006), the authors comment that:

> On the other hand, the simultaneous increase in prices and in investor interest, especially by speculators and index traders, in commodity futures markets in recent years can potentially magnify the impact of supply-demand imbalances on prices. Some have argued that high investor activity has increased price volatility and pushed prices above levels justified by fundamentals, thus increasing the potential for instability in the commodity and energy markets.
>
> What does the empirical evidence suggest? A formal assessment is hampered by data and methodological problems, including the difficulty of identifying speculative and hedging-related trades. Despite such problems, however, a number of recent studies seem to suggest that speculation has not systematically contributed to higher commodity prices or increased price volatility. For example, recent IMF staff analysis (September 2006 World Economic Outlook, Box 5.1) shows that speculative activity tends to respond to price movements (rather than the other way around), suggesting that the causality runs from prices to changes in speculative positions. In addition, the Commodity Futures trading Commission has argued that speculation may have reduced price volatility by increasing market liquidity, which allowed market participants to adjust their portfolios, thereby encouraging entry by new participants.

[46] First Interim Report on Oil Price Developments and Measures to Mitigate the Impact of Increased Oil Prices, European Commission (September 1, 2008).

[47] "Commodity Index Investing and Commodity Futures Prices", Hans. R. Stoll and Robert E. Whaley, (September 10, 2009). A study preceding the Stoll and Whaley review is consistent with other academic literature in concluding that trading by large hedge funds and CTAs is based on private information about market fundamentals, supporting the view that hedge funds and CTAs benefit market efficiency by bringing valuable information to the market through their trading. Holt, Bryce R.; Irwin, Scott H., "The Effects of Futures Trading by Large Hedge Funds and CTAs on Market

study concluded, among other things, that "commodity index rolls have little futures price impact, and inflows and outflows from commodity index investment do not cause futures prices to change. . . "[48]

Several of these studies make use of the new disaggregated data that has been made available by the CFTC for its Commitment of Traders Reports.[49] Once again, these studies by professional economists are consistent in generally demonstrating the absence of evidence of excessive speculation[50] or demonstrating that the price activity of U.S. oil futures contracts are generally consistent with market fundamentals.[51]

F. Flaws in Assertions of Undue Role in Commodity Markets by Speculators

Well-regarded economists who have reviewed the work of those new "experts" that have been lobbying for restrictive positions limits and the exclusion of swap dealers and index funds from futures markets, have found, among other flaws that the proponents of the restrictions demonstrated:

(1) unfamiliarity with industry fundamentals resulting in misinterpretation of petroleum statistics;
(2) confusion of the consequence of demand for physical product and demand for derivatives;
(3) use of overly simplistic models;

Volatility." Proceedings of the NCR-134 Conference on Applied Commodity Price Analysis, Forecasting, and Market Risk Management. (April 2000).

[48] Stoll and Whaley at page 3.

[49] As noted on the CFTC's website, the Commission commenced publishing a Disaggregated Commitments of Traders (Disaggregated COT) report on September 4, 2009. The Disaggregated COT report separates traders into the following four categories of traders: Producer/Merchant/Processor/User; Swap Dealers; Managed Money; and Other Reportables. The legacy COT report separated reportable traders only into "commercial" and "non-commercial" categories.

[50] One researcher analyzed three years of data released by the CFTC in October 2009 in the Disaggregated COT. Based on traditional speculative metrics, the researcher concluded that, reviewing data from June 13, 2006 to October 20, 2009, the balance of outright speculators in NYMEX oil futures and options markets was not excessive relative to hedging activity (in those same markets) during that period. "Has There Been Excessive Speculation in the US Oil Futures Markets? Hilary Till, EDHEC Risk Institute (November 2009).

Similarly, another study, which also made use of the new disaggregated data, concluded that changes in positions and changes in commodity prices are principally driven by changes in economic conditions. This study also found that changes in futures positions that are not correlated to economic conditions (current or future) have only a modest impact on commodity price volatility and no medium-term effect on price levels. "Commodity Prices and Futures Positions" Ruy Riberio (J.P.Morgan) (December 16, 2009). Barclays Capital also interpreted the dataset of disaggregated data released by the CFTC and concluded that the data strongly supports the notion that swap dealers are providing liquidity to those with physical risks to manage. "Barcap says speculators are not to blame." Izabella Kaminska (Financial Times), Ftalphaville.com/blog, (September 8, 2009).

[51] "An Evaluation of the Performance of Oil Price Benchmarks During the Financial Crisis," Craig Pirrong (November 16, 2009). In this review, Dr. Pirrong concluded that the behavior of the WTI futures contract during the financial crisis reflected the "truly unprecedented conditions during that period." (page 4). Dr. Pirrong also found that, for most of the period studied, there was a strong relationship between Cushing stocks (at the delivery point for the WTI futures contract on NYMEX) and spreads, and that this was the relationship that would be predicted by economic theory. In other words, "higher stocks are associated with a rise in deferred price. This is consistent with a market being driven by fundamentals." (page 3). (This study was commissioned by the CME Group.)

(4) arbitrary and meaningless characterization and measurement of "excessive speculation";
(5) misstatement of volatility trends; and
(6) conflation of speculation and market manipulation.

The academic work and the contemporaneous explanations of price movements in commodities markets have been largely ignored by a few vocal critics, who have gained an undue share of attention by making sensational claims. For example, one such critic, Michael Masters, claimed that buy and hold index traders poured more than $60 billion into the major commodity indices in January through May of 2008, resulting in the purchase of approximately 187 million barrels of WTI crude oil futures causing WTI crude prices to soar by nearly $33 per barrel as a result of this buying pressure.[52] However, this critic's contentions were proved false in every material respect in 2008 by serious scholars. As noted in the 2008 Staff report, there was in fact a net reduction in the futures-equivalent swap positions in crude oil, which constituted an 11% decline over the first six months of 2008, contrary to the claims of that critic.[53]

Certain market participants, such as some index funds, may seek to maintain a long position in a commodity contract (in order to benefit from possible future increases in price) without having a particular view regarding specific future changes in market prices. Consequently, these participants, who are sometimes referenced as "passive longs", will engage in a trading strategy of maintaining long positions in the front month of a commodity contract and then offsetting that position and establishing a new long position in the next contract month. The offset of the existing long position and the establishment of the new long position in the next contract month are usually referred to as the "roll". The roll is typically the simultaneous sale of the nearest to termination position and purchase of a position in the next nearest month to maintain the investment, i.e., sell the first month contract and buy the second month contract.

A small group of non-academic critics has focused on the fact that such passive long traders will be establishing long positions in each new contract month and assert that this will thus inevitably translate

---

[52] "The Accidental Hunt Brothers – Act 2", A Paper A Paper by Michael Masters and Adam K. White" by Philip K. Verleger and David Mitchell (September 10, 2008), p. 3.

[53] See e.g., "Comments on the 'Accidental Hunt Brothers –Act2,' A Paper by Michael Masters and Adam K. White" by Philip K. Verleger and David Mitchell (September 10, 2008). In this paper, Verleger and Mitchell review a report issued by Masters and White. In the report being reviewed, Masters and White, according to Verleger and Mitchell, start with the premise that speculators caused the price rise and then claim to prove the point. However, Verleger and Mitchell summarize this report by referring to it as "100-percent fiction." Indeed, at the end of their review, they comment further that the paper by Masters and White is:

> "the worst example of junk economic analysis published in a very long time. The authors demonstrate nothing in the article. It is devoid of any intelligent content. One can make a stronger case for a rooster's crow causing the sun to rise."

As another example, in January 2010, Dr. Bassam Fattouh, Senior Research Fellow at Oxford Institute for Energy Studies, provided a paper for a meeting of the world's energy ministers. However, this paper is now publicly available online at http://www.oxfordenergy.org/pdfs/WPM39.pdf. In his paper, Fattouh concluded that there was little conclusive evidence regarding the culpability of speculators on crude prices. "Oil Market Dynamics Through the Lens of the 2002-2009 Price Cycle", Bassam Fattouh, Oxford Institute for Energy Studies (January 2010). This paper is discussed in "The Oil Price Problem" by Kate Mackenzie, ft.com (January 28, 2010).

into increased demand for futures contracts leading to higher prices. However, this reflects an incomplete description and comprehension of the trading dynamics involved. Because such passive long traders cannot make or receive delivery of the physical commodity, they necessarily must liquidate their positions by establishing offsetting short positions, which would then have the same downward effect on price that is being asserted concerning upward price impact from the establishment of the long position.

All other things held equal, the roll leads to a price drop in the first month and a price rise in the second month or contango.[54] If passive long investment dominated price determination for oil, then oil would always be in contango, which means that the price of oil in future months is always higher than the current month price. However, the evidence shows that this is not true. An analysis by CME Group of a period of three months of futures on a rolling basis dating back to 2000 (and measured either as contango, backwardated or mixed) confirms that there were numerous periods when the market was not in contango, Consequently, passive long investors have not exerted a dominant effect on oil prices.[55]

G. Other Observations

Futures markets operate best when they serve as an efficient forum for price discovery by offering a transparent auction market that reflects and incorporates many informed views on the forward supply and demand fundamentals. In other words, futures markets provide a forum where participants can generally provide a view on future supply and demand fundamentals through their trading. While commercial participants are a necessary component of physical commodity markets, speculators also can have informed views on future prices. Restricting the market participants that provide information to the market does not change that basic need for the market to reflect a centralized view on the future. But as a result of such restrictions, market prices instead would be based on a less informed view. Simply put, if new regulatory restrictions were to remove speculators from the commodity futures market or even provide substantial disincentives to their market participation, the end result would be for that futures market to operate with fewer informed views and less information, which would diminish the price discovery mechanism.

Proponents of position limits on speculative trading and the elimination of risk management exemptions believe that such limits will bring commodity prices to some favored level. However, there is a serious disconnect between the perceived implicit promise (of position limits) to control price moves and the ability of position limits to deliver on that promise. While position limits cannot offer any such benefits, improperly calibrated and administered position limits can easily distort markets and substantially increase costs to hedgers, which in turn increases costs to consumers.

In the Proposal, the CFTC makes repeated reference to the Federal position limits on the enumerated commodities but does not show how those limits have had any impact specifically on

[54] Contango is defined in the glossary available on the CFTC's website as a "market situation in which prices in succeeding delivery months are progressively higher than in the nearest delivery month; the opposite of backwardation.

[55] "Futures and Physical Markets-Links: A Test", a paper presented by Robert Levin (CME Group) at the IEA and IEEJ Workshop on Oil Prices, Tokyo Japan (February 25, 2010).

excessive speculation or more generally on prices in such commodities. In fact, the historical record has demonstrated over time that where position limits have been imposed for specific agricultural commodities, there is no observed change in pricing patterns. Indeed, as Commissioner O'Malia observed in his Concurring Statement, which was included in the Proposal, despite federal limits on enumerated agricultural commodities, contracts such as wheat, corn, soybeans and cotton still experienced substantial price increases.[56]

VII. Concerns that the Formulation of Limits is Flawed

A. The Proposed Conditional Limits Would Impair the Price Discovery Function

The Proposal would permit "conditional limits" in that it would allow a trader to acquire or hold positions in a cash-settled spot-month class of contracts that is five times greater than the "default" spot-month limit upon satisfying certain conditions.[57] A trader would be permitted to hold positions under this conditional-spot-month limit only if that trader does not hold a position in any physically-delivered referenced energy contract to which its cash-settled positions are linked in the spot month. In addition, a trader would need to file certain data with the exchange during the expiration or spot month period.

The proposed Conditional Limits in the spot month for financially settled contracts could impair the efficiency and effectiveness of the market's price discovery function. Use of the Conditional Limit, and the associated prohibition from trading in the physical contract could result in a shift of volume and open interest away from the physically settled futures contract. A decrease in liquidity would diminish the value of the critical price discovery mechanism provided by the physical contract. This would adversely affect all market participants. For instance, a swap dealer who traditionally maintained positions in the spot month hedging its financial exposure may wish to avail itself of the larger Conditional Limit because the proposal does not allow swap dealers any exemption in the spot month. Such a dealer then could not trade the underlying physically settled futures market and the traditional role the dealer would play in price discovery and liquidity for the physical contract would be compromised. This may also result in wider and more volatile expirations. As a result, there is significant concern that the central price discovery function served by our regulated markets would be undermined.

The Commission's proposals regarding Expiration Limits and Conditional Limits creates a clear bias to shift use from the Expiration Limit contract—the *Primary* physical delivery underlying contract, which maintains position limits, to the Conditional Limit contract(s)—*Derivative* cash-settled contract(s). This bias is analogous to increasing the cost in using the primary contract and simultaneously reducing the cost in using the derivative contracts. It is axiomatic that participation will shift from the primary to the derivative. This bias is concentrated in the Expiration Limit period—the final three days of trading of the primary contract—but its impact would carry to all periods; over time, there would be continually

---

[56] 75 Fed. Reg. 4144, at 4172.

[57] For cash-settled contracts based on the prices of physically-delivered futures contracts, the Proposal would establish a "default" spot-month position limit equal to that of the cash-settled contract's physically-delivered counterpart.

decreasing incentive to place a position in the primary physically settled futures contract altogether versus the derivative contracts because the costs and effort associated with shifting from the primary to the derivative contracts leading up to the Expiration Limit period.

Any such non-market-based shifts in volume from the primary to derivative contracts will serve as exogenous shocks beyond those markets. In particular, they would radiate to the physical and OTC markets and have material impacts there as well. In the natural gas market, these proposals specifically would affect the convergence between the primary and physical delivery markets. Simply stated, the proposed use of Conditional Limits would directly and strongly encourage non-commercial participants and swaps-dealers to shift from participating in the primary contract.

As indicated above, this shift would not simply be during the days immediately preceding the Expiration Limit period for the expiring contract, but would, over time, extend to discouraging establishing any positions in the primary contract in the first instance. The decrease of non-commercials and swap dealers from the primary contract would lead to lower liquidity in the primary contract. This reduction in liquidity would likely manifest itself through the following:

- Transactions would take longer to execute, especially transactions (or connected groups of transactions) for larger quantities.
- Some transactions would simply not be executed or at least not transacted in full; it may take so long to execute, market circumstances may change and render the originally intended transaction moot or unable to be completed.
- The bid-offer spread would widen for some transactions.

In addition, among commercial participants, there are several groups who would not have a strong commercial tie to the primary contract versus derivative contacts and, correspondingly, will follow where liquidity performance is better. These commercials include those firms who use our futures markets purely for risk management purposes without participating in the physical delivery process and those firms whose underlying physical market positions or business risks are geographically or commercially remote from the primary contract's physical delivery mechanism. Currently, the existing levels of participation by commercials in the physical delivery process is such that there is reliable price convergence between the cash and futures markets. With the implementation of the Conditional Limits proposal, this convergence cannot be ensured.

Consequently, there is the additional prospective impact of materially and negatively impacting the liquidity in the primary contract as well as the price-convergence process between the primary contract and the physical market. Specifically, the resulting impact of this proposal could include reducing liquidity sufficiently in the expiring primary contract such that the primary futures contract does not respond quickly or fully to physical-market transactions and impulses. In addition, the primary contract could suffer, as a consequence of these proposals, a liquidity vacuum during the Expiration Limit period.[58]

[58] The form of such a vacuum would be:

In addition, reducing liquidity in the primary physically settled contract during the Expiration Limit period would result in making each physical market transaction during that period more influential on the expiring contract's price determination. Some market participants may be in a better position to exercise this influence than others.

The cash-settled contracts that are derivative contracts of the primary physically settled contract are intended to lean on the primary contract, not displace them.[59] It is the Exchange's position that a reduction in open interest and commensurate liquidity from current levels in the primary physical contract as a result of this proposed conditional limit would be poor public policy; especially under the facade of protecting against excessive speculation without any justification.

VIII. The Proposed Exemptions are Unduly Burdensome

Under the CFTC Proposal, exemptions would continue to be available for positions that qualified as a bona fide commercial hedge for physical exposures. In addition, the Proposal would create a new swap dealer financial "risk management" exemption and would not permit an exemption for index traders. In reviewing these exemptions, we have a number of comments and concerns as set forth below:

A. Swap Dealers Should Be Treated Consistent with Other Bona Fide Hedgers

In the Proposal, the Commission observed that swap dealers "can perform an important economic function by taking on risks to accommodate the specific hedging and risk management needs of various customers. Swap dealers often are able to aggregate and standardize these otherwise particularized risks, and in turn, enter into commodity futures and option contracts to manage them.[60] We agree with the Commission. As noted in the 2008 Staff Report, "futures market trades by swap dealers are essentially an amalgam of hedging and speculation by their clients. Thus, any particular trade that a swap dealer brings to the futures market may reflect information and decisions that originated with a hedger, a speculator, or some combination of both."[61]

- Sudden and severe price volatility during the Expiration Limit period. (This should not be confused with allegations of high volatility during the primary contract's closing range period that previously arose because of excessive reliance by commercial participants on the final-settlement price for the primary contract as the pivotal reference for almost all physical market transactions; perhaps that would be considered to be *excessive commercialization.*)

- Very specific reported non-responsiveness of the futures market to comparable physical market transaction prices during the Expiration Limit period.

- Material increases/decreases in the number of futures contracts expiring into physical delivery obligations. Increases could represent an attempt to bridge non-traditional market price gaps through arbitrage. Decreases could be a sign of liquidity being drawn away from the system.

[59] Previously, the Commission and the Federal Energy Regulatory Commission strongly encouraged NYMEX to pierce the cover of Expiration Limit period participants' positions in derivative markets. NYMEX observed that this led, over the year following the implementation of this practice, to a reduction of approximately 20% of open-interest during the Expiration Limit period.

[60] 75 Fed Reg. 4144, at 4160.

[61] 2008 Staff Report at page 1.

Swap dealers are legitimate hedgers that should continue to be allowed to qualify for an exemption from speculative position limits pursuant to the existing "bona fide hedging" definition. As the Staff Report explains, the products offered by swap dealers play an important role in the financial markets:

> [F]or many financial entities, the OTC derivatives products offered by swap dealers have distinct advantages relative to futures contracts. While futures markets offer a high degree of liquidity..., futures contracts are more standardized, meaning that they may not meet the exact needs of a hedger. Swaps, on the other hand, offer additional flexibility since the counterparties can tailor the terms of the contract to meet specific hedging needs.[62]

Swap dealers that assume risks in the OTC market, which are consistent with their legitimate businesses, should be able to transfer the residual market risk from their swap books to the futures markets under current standards for exemptive relief. Increased restrictions on swap dealers' ability to obtain exemptions from position limits will likely cause two unintended yet foreseeable consequences. First, limiting the hedge exemption for swap dealers could make it more costly for commercial enterprises and institutional investors to execute strategies in the OTC market to meet their hedging needs as swap dealers may be left trying to more carefully internalize offsets versus simply utilizing futures as a quick reliable means of offsetting risk. Second, swap dealers may well widen spreads in order to internalize risks or attempt to hedge their risk through increased use of OTC instruments rather than exchange-traded futures.

Both strategies undercut current regulatory and legislative efforts to reduce systemic risk by driving OTC-generated risk into a central counterparty clearing context. Finally, the assertion that swap dealers were regularly and widely being used as intermediaries by speculators and others who would not have been entitled to a hedge exemption as a device to circumvent exchange position limits has been contradicted by the information so far released by the Commission of data obtained from swap dealers by use of its special call authority.

The Proposal defines "swap dealers" so that an entity may act either as a swap dealer or hedger; if an entity, however, receives a hedge exemption, the entity may not act in both capacities. As a result of the proposed exemption process, the proposal could have a significant impact on existing business operations of those entities which have integrated operations consisting of swap dealing and hedging activities. These entities are valuable participants in our markets and the effect of implementation of such an exemption could be significant. The proposed structure runs contrary to the established use of these markets for hedging of integrated exposure and speculation. This could have a chilling effect on business brought to the Exchange's energy markets and may result in business moving to other non-CFTC regulated markets, which, in turn, may make our markets less efficient and the existing transparent trading will move and become opaque.

[62] 2008 Staff Report at page 11.

In addition, the breadth of the definition of "swap dealer" will capture some traditional commercial hedgers.[63] Thus, by being placed in just one of these mutually exclusive categories, a market participant will likely find that not all of its activity is eligible for an exemption. The rationale for restricting a large commercial hedger with respect to its ability to hold open positions as a swap dealer is unclear.

The circumstances under which exemptions will be granted will be much more restrictive than under the existing regime. Under the Proposal, exemptions would be available for bona fide commercial hedgers with physical exposure and swaps dealers qualifying under a newly created financial "risk management" exemption. However, with limited exception, market participants who hold positions pursuant to a hedge exemption are precluded from holding any speculative positions. Moreover, the commercial and swap dealer exemptions are not handled equivalently. A commercial participant has no restriction per se as to the size of the exemption; however, any entity that receives a hedge exemption on a single-month or all-months basis in excess of two times the position limit would be prohibited from holding any open positions as a swap dealer. On the other hand, swap dealers operating under the exemption are limited to two times the position limit (on a single-month or all-months-combined basis), and exemptions are not permitted in the spot month.

In our view and as we have stated previously to the Commission, no "overall" position limit cap should be imposed on swap dealers who, as previously noted, generally hedge their net swap exposure acquired from trades with an amalgam of commercial and non-commercial clients. Swap dealers already must apply for and be granted an exemption in order to exceed position limits. Such exemptions are granted at the discretion of the exchanges and the Commission (in the case of products with Federal limits) and are subject to terms and conditions as the regulators deem appropriate to protect the integrity and orderly functioning of the market.[64]

A. A Hedge Exemption Should be Available for Index and Exchange-Traded Funds

Although the Proposal includes a specific question relating to the role of index funds, the proposed new regulations do not include any manner of exemption for index or exchange-traded funds. Index funds aggregate the buying and selling decisions of many thousands of investors, most of whom are diversifying their investment portfolios and hedging inflation risks to their investment returns in order to maximize their retirement savings and their individual wealth. A core function of commodity markets is to provide a forum for transferring commodity price risk. Thus, for example, commercial producers may

[63] Under the Proposal, the term "swap dealer" would be defined, solely for purposes of the new Federally set position limits as: "any person who, as a significant part of its business, holds itself out as a dealer in swaps, makes a market in swaps, regularly engages in the purchase of swaps and their resale to customers in the ordinary course of a business, or engages in any activity causing the person to be commonly known in the trade as a dealer or market maker in swaps: Thus, if a commercial entity regularly purchased swaps and resold them to its customers, it could fall within the scope of this definition.

[64] NYMEX/COMEX Rule 9A.29, for example, specifies that one factor considered in establishing an appropriate exemption level is the "liquidity, depth and volume of the market in which the exemption is sought" and allows the regulatory staff "to modify, revoke or place limitations on the exemption" at any time. In addition, all exemptions are granted subject to a requirement that the participant initiate and liquidate positions in an orderly manner.

have market price risk that they wish to shed, and other market participants, including speculators such as index funds, are willing to accept and bear that risk. A key aspect of the market structure for futures markets that allows for efficient transfer of that price risk is that this price risk can be transferred without any need for transfer or exchange of the physical commodity. In other words, speculators such as index funds provide value to producers by serving as a stable pool of liquidity for producers seeking to transfer price risk. Producers benefit from the liquidity provided by index funds because it makes it easier and more economical for these producers to shift price risks off their balance sheet.

However, because of the absence of exemptions for index funds and exchange traded fund customers, such entities would need to establish any significant derivatives exposure indirectly through swap dealers or restructure its fund to decrease its reliance on U.S. commodities and shift to non-U.S. products. We believe strongly that index investors likewise are critical to the orderly functioning of the futures markets and should be eligible, under certain circumstances, to an exemption from position limits.

Moreover, because index investors lack the wherewithal to make or receive delivery of the physical crude oil, by necessity they must close out and offset their initial long position in a contract month by purchasing a short position in that contract month prior to termination of trading for that contract. Therefore, index investors do not create artificial demand. Those wishing to exclude index investors from the futures markets, however, tend to focus on the alleged market impact of index investors when such traders establish a long position in a contract month but somehow fall strangely silent concerning any possible price impact by index investors when they execute significant sales to liquidate their open long position.

B. The Proposal's "Crowding-Out" Provisions Will Have a Negative Impact on Participants in Regulated Markets

Under the proposed regulations, traders holding positions pursuant to a bona fide hedge exemption would generally be prohibited from also trading speculatively or be eligible for a risk management exemption. If bona fide hedging positions outside the spot month exceed twice an otherwise applicable all-months-combined or single-month position limit, then such traders thus would also be prohibited from holding positions as swap dealers. In addition, swap parties that are exempted subject to an any one month or all months basis cannot maintain any speculative positions.[65]

In the Proposal, the Commission refers to these restrictions as "crowding out" provisions and does not offer a clear rationale for these restrictions. Instead, with regard to the crowding out restrictions attached to a bona fide hedge exemption, the Commission simply notes that the purpose of these restrictions was not to impede a trader's ability to engage in hedging, but rather to limit the trader's ability

[65] Further, swap parties acting pursuant to an exemption will need to periodically file forms with the CFTC citing underlying exposure. Such filing may have a chilling effect on the participation by parties who may be concerned about CFTC challenge on the nature of the underlying exposure as an allowed offset versus a prohibited speculative position.

to acquire swap dealer risk management positions or speculative positions when that trader holds significant positions pursuant to a hedge exemption.[66]

There is no precedent or basis for such crowding out provisions, and we cannot discern any clear policy rationale for this approach. Historically, the CFTC's hedge exemption regime has consistently permitted a market participant to establish speculative positions up to the applicable position limits and to obtain hedge exemptions, if eligible, for hedging positions above these levels. This practice has been based on the understanding that hedging positions eligible for exemption, even if held by an entity that also maintains speculative positions, does not present the market concern for which position limits are designed. The impact of these provisions, if the Proposal should be implemented in its current form, would be to create yet another distinct and significant disincentive to use CFTC-regulated markets, which could further reduce liquidity on these transparent and regulated markets.

C. An Exemption Should Be Available for Independent Account Controllers From Position Aggregation Requirements

The Proposal would establish account aggregation standards specific to positions in the applicable energy contracts. In general, the Proposal would aggregate positions in accounts at both the account owner and controller levels. Under the position limits framework in place for agricultural commodities, eligible entities (such as mutual funds, commodity pool operators (CPOs) and commodity trading advisors (CTAs)) and futures commission merchants (FCMs) are permitted to disaggregate positions pursuant to an independent account controller exemption. Entities claiming this exemption are required, upon call by the Commission, to supply information supporting their claim that the account controllers for the applicable positions are acting independently.

In our White Paper, we expressed support for the aggregation of ownership approach used in Part 150 for agricultural commodities, which includes this independent account controller exemption from aggregation. However, the Proposal does not provide for an independent controller exemption for energy contracts.[67] The Proposal does not provide any real justification or rationale for varying from this approach used for agricultural commodities and instead simply observes that such an exception "may be incompatible" with the Proposal.[68]

In our view, this exemption should be made available for aggregation standards for energy commodities as well as for agricultural commodities. When multiple independent traders are trading for a fund, for example, there does not seem to be a clear policy rationale for treating their independent trading actions as if their combined positions were the same as a single entity that might be trying to have an impact on prices . In other words, the positions of traders who trade independently should not be

---

[66] 75 Fed. Reg. 4144, at 4159-4160.

[67] We also note that, as an additional contrast to the approach used for such agricultural commodities the crowding out restrictions set forth in the Proposal are not a part of the regulatory structure for Federal limits for agricultural commodities.

[68] 75 Fed. Reg. 4144, at 4161.

aggregated because they have no combined effect on the market. We believe that the absence of this exemption is unwarranted and unnecessary.

Moreover, it is not clear to us how this particular approach can be deemed to be "necessary" in order to prevent excessive speculation. In addition, notwithstanding the independence of traders and business units, as a result of the absence of this exemption, otherwise eligible entities now would become more likely to exceed the limits and could need to restrict their current activity.[69]

IX. <u>The Proposal Would Perpetuate and Further Codify the Existing Loophole for Uncleared Significant Price Discovery Contracts</u>

In 2009, the CFTC issued final rules[70] to implement provisions of the CFTC Reauthorization Act of 2008 ("Reauthorization Act") concerning SPDCs on ECMs.[71] The Reauthorization Act extends the CFTC's regulatory oversight to the trading of SPDCs and requires ECMs to adopt position limit and accountability level provisions for SPDCs. That act also authorizes the Commission to require the reporting of large trader positions in SPDCs and establishes core principles governing ECMs with SPDCs.

However, in the final rules, the CFTC followed the approach set forth in the proposed rulemaking and limited the application of position limits and position accountability levels to cleared trades in SPDCs. Noting the concerns that had been raised by numerous commenters about this approach, the Commission explained that these issues and concerns "merit further attention and study" but the Commission was nonetheless mindful of the statutory time constraints imposed by the Reauthorization Act for the issuance of final rules.[72]

As a result, out of "an abundance of caution", the CFTC determined not to make final its proposed acceptable practices concerning uncleared trades in SPDCs but instead announced its intent, upon publication of these final rules, immediately to examine these issues and to issue a notice of proposed rulemaking that specifically addresses appropriate guidance and acceptable practices for uncleared trades on ECMs.[73]

To date though, no such proposed rulemaking has been released for public comment. Pending Congressional legislation may provide another response to address this discrepancy. However, the

---

[69] Also, as a result of the application of this aggregation approach, it could become more likely that the firms would be confronted with the consequences of the crowding-out provisions.

[70] 74 Fed. Reg. 12178 (March 23, 2009).

[71] The Reauthorization Act was incorporated as Title XIII of the Food, Conservation and Energy Act of 2008, Public Law 110-246, 122 Stat. 1624 (June 18, 2008).

[72] 74 Fed. Reg. 12178, at 12181.
[73] Id.

reality is that, in this one area of uncleared SPDC trades, the CFTC already clearly has statutory and jurisdictional authority over these OTC trades; but it has not exercised that existing authority. Consequently, the fact remains that, notwithstanding a CFTC determination that a particular product should be deemed to be a SPDC, uncleared positions in that SPDC at present continue to remain essentially unregulated, and a market participant is free to have uncleared positions in that SPDC that have no limits or other restrictions on size.

X. The Proposal Seriously Underestimates the Actual Costs, These Costs Greatly Exceed any Possible Benefits, and the Proposal Also Undermines Public Policy Goals

A. The Proposal Would Impose Substantial Costs on Regulated Markets

Section 15(a) of the Act requires the Commission to "consider" the costs and benefits of its actions before issuing new regulations under the Act. Section 15(a) further specifies that the costs and benefits of new regulations shall be evaluated in light of five broad areas of market and public concern: (1) protection of market participants and the public; (2) efficiency, competitiveness, and financial integrity of the market for listed derivatives; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations.[74] For the reasons stated below, we disagree with the Commission's analysis of the costs and benefits of the Proposal, with respect to the impact of the Proposal on price discovery, efficiency and competitiveness. We also find that the Proposal's cost-benefit analysis severely underestimates the costs and that these costs would greatly exceed any hypothetical benefits from the Proposal.

In the cost-benefit analysis section of the Proposal, the Commission notes generally that the proposed position limits could cause unintended consequences and costs by decreasing liquidity in the markets for the referenced energy contracts, impairing the price discovery process in these markets, and pushing large positions to trading venues over which the Commission has no direct regulatory authority. We agree, but rather than characterizing such a result as "unintended consequences," we believe that it is more accurate to view them as clearly foreseeable and indeed inevitable results.

If the Proposal became effective in its current form, there would certainly be a significant shift of volume and open interest away from regulated futures markets, with the consequent negative impact on price discovery and liquidity. Imposing position limits for energy commodities traded on U.S. exchanges would significantly impact the trading volume in those markets.

Curiously, the CFTC asserts that the Proposal would only affect "possibly ten traders."[75] Moreover, focusing specifically on crude oil, at the CFTC's open meeting on the rulemaking proposal held on January 14, 2010, the Commissioners were advised that only a total of three unique traders would have been affected over a period of two years if the rules had been in effect. Consequently, the

[74] 75 Fed Reg. 4144, at 4164.
[75] 75 Fed Reg. 4144, at 4164.

Commission concludes in the Proposal that the "compliance costs associated with the proposed limits and their impact on the efficiency of the markets for the referenced energy contracts would be "minimal."

We strongly disagree with this conclusion. This cost-benefit assessment appears to be largely a static focus on positions recently held by unique traders. However, such a focus strikes us as unduly narrow in that it does not attempt to assess in any meaningful way the numerous structural disincentives that will be created for participants using futures markets.

For example, with respect to swap dealers, we note that in a recent speech, Dr. Philip Verleger commented that, at that same open meeting, the CFTC Commissioners received a presentation from CFTC staff on the impact of the proposed limits. This presentation included a table that showed that 19 unique owners of gasoline futures and 16 unique owners of heating oil would have been affected by the proposed rules if such rules had already been in effect. Verleger then went on to observe in his speech that, based on information made available from the CFTC's database on traders in energy contracts, there was a total of 19 swap dealers in the gasoline contract over the last two years that were reflected in that database. Similarly, the maximum number of swap dealers in the heating oil contract was 20. Thus, as Verleger noted, the new regulations would have affected a high percentage of the firms doing swaps in heating oil in the recent past.[76]

More generally, the Proposal would establish a new and arguably complex system of multiple layers of restrictions on positions in the referenced contracts. However, the Proposal's cost-benefit analysis essentially ignores and does not consider or weight the systems changes and other significant compliance costs that would become necessary in order to remain in compliance with the multiple sets of limits that are proposed to be implemented.[77]

The Proposal also does not address the internal costs that would be imposed on entities with integrated operations, or the internal costs related to the absence of an independent controller exemption to the aggregation requirements. In addition, the Proposal does not weigh the cost on regulated markets posed by the significant disincentives represented by the crowding-out provisions. For example, an entity that engages in both trading in the physical cash commodity and in trading as a swap dealer and that applies for a bona fide hedge exemption to hedge its physical activity generally would thus be crowded out from engaging in any speculative trading or in obtaining a separate risk exemption to hedge its swap activity.

In the Proposal, the CFTC compares its approach in some detail with the approach broached by the CME Group in its 2009 White Paper. This comparison includes a table contrasting the position limits as calculated under the CFTC's approach with the limits that would be generated under the White Paper.

[76] "First Do No Harm". Speech to the Futures Industry Association. Boca Raton, Florida (March 11, 2010).
[77] A financial newsletter, in summarizing a recent industry conference, noted that implementing the limits structure set forth in the Proposal would involve managing limits on a real-time basis at both the firm and trader level and commented that the Proposal at a minimum thus would involve a significant level of investment spending in order to ensure compliance. "Takeaways from OTC Clearing Conference" Ticonderoga Securities Industry Update (April 14, 2010).

While the CFTC position limits in most instances are higher than those resulting from the White Paper approach, it should be noted that the CME's approach does not include the significant disincentives embedded in the Proposal, including the absence of an exemption for independent controllers and the absence of an exemption for index funds. In other words, a simplistic calculation of costs and benefits focused only upon the immediate impact of existing traders of the new proposed limits that ignores the internal costs of firms and also ignores the substantial structural disincentives is destined to understate severely the many real costs of the Proposal.

Position limits are not a costless remedy. Position limits, when improperly calibrated and administered, can easily distort markets, increase the costs to hedgers and effectively increase costs to consumers. Indeed, in his Boca Raton speech, Verleger estimated that efficient and liquid derivatives markets have saved consumers at least $20 billion during this most recent winter season. Verleger commented that energy prices had not spiked during the most recent winter even as temperatures plunged in the Eastern U.S. because non-commercial participation, including index investing in future markets, contributed to record inventories of oil and natural gas.[78] However, he was then quoted to warn that the imposition of overly restrictive limits would mean that the "absence of U.S. inventories could cost buyers another $20 billion the next time extremely cold weather hits."[79]

Unfortunately, many demands for speculative limitations assume that severe limits on speculation will bring prices to some favored level. On the contrary, position limits on futures contracts will not and do not control cash market prices. There is a complete disconnect between the implied promise to drive prices down or up, whichever the most vocal constituency desires, and the ability of position limits to deliver on that promise. Imposing artificial costs and constraints on speculation in markets regulated by the CFTC is likely to drive prices to artificial levels, which can distort future production decisions and cause costly misallocation of resources of production.

B. <u>The Proposal Would Undermine Important Public Policy Goals</u>

We also continue to believe that, as we noted last year in our White Paper, certain tests should be applied to any proposal regarding mandatory Federal position limits. First, any such proposal must ensure that the Federal limits do not have a detrimental effect on the price discovery and hedging functions of futures markets or drive trading to unregulated markets. Second, the proposal also must fully support the national policy of enhancing transparent markets and central counterparty clearing.

We have concluded regrettably that the Proposal fails both tests. Rather than ensuring the absence of harm, the Proposal instead inevitably would have a detrimental effect on the price discovery and hedging functions of futures markets by driving trading to unregulated markets. This is exactly counter to the national policy of enhancing transparent markets and central counterparty clearing.

---

[78] "Energy Trading Limits May Cost Users $20 Billion, Verleger Says" Bloomberg (March 11, 2010).

[79] Id.

In other words, the Proposal would trigger the special concern expressed by Commissioner Sommers in her dissenting statement (opposing issuing the Proposal for public comment) in that it would have "the perverse effect of driving portions of the market away from centralized trading and clearing at the very time that we are urging all standardized OTC activity to be traded on-exchange or cleared."[80]

XI. Conclusion

We support the Commission's statutory mission. We also support appropriate new CFTC authority over other OTC trading venues. However, for the reasons set forth in this comment letter, the CME Group respectfully requests that the Commission not adopt the Proposal. At a minimum, we believe that the Proposal is premature in light of pending legislation and should be deferred to allow completion of that legislative process. In addition, the Proposal would not satisfy the statutory finding necessary under the CEA and if implemented in its current form would harm U.S. futures markets.

CME Group thanks the Commission for the opportunity to comment on this matter. We would be happy to discuss any of these issues with Commission staff. If you have any comments or questions, please feel free to contact me at (312) 930-8275 or Craig.Donohue@cmegroup.com; or Brian Regan, Managing Director, Regulatory Counsel, at (212) 299-2207 or Brian.Regan@cmegroup.com.

Sincerely,

Craig S. Donohue

Craig S. Donohue

cc: Chairman Gary Gensler
Commissioner Michael Dunn
Commissioner Bart Chilton
Commissioner Jill Sommers
Commissioner Scott O'Malia
Thelma Diaz

[80] 75 FR 4144, 4171.

Appendix A

1. ARE FEDERAL SPECULATIVE POSITION LIMITS FOR ENERGY CONTRACTS TRADED ON REPORTING MARKETS NECESSARY TO "DIMINISH, ELIMINATE, OR PREVENT" THE BURDENS ON INTERSTATE COMMERCE THAT MAY RESULT FROM POSITION CONCENTRATIONS IN SUCH CONTRACTS?

   - Under Section 4a of the CEA, the CFTC must find that speculative limits are "necessary" to prevent the burdens of unreasonable price fluctuation or unwarranted price changes caused by excessive speculation. As a note, Section 4a by its terms does not address or refer to position concentrations. Thus, this question solicits replies that are not directly responsive to the analysis applicable to the necessary finding that is required by statute.

     The Proposal did not provide any evidence to support the finding required under Section 4a. We do not believe that there is any credible academic or other research evidence identifying any harmful impact on futures prices from speculative activity. Furthermore, we do not believe that the case has yet been made that Federal position limits as set forth in the Proposal can have an impact and thus are somehow necessary.

2. ARE THERE METHODS OTHER THAN FEDERAL SPECULATIVE POSITION LIMITS THAT SHOULD BE UTILIZED TO DIMINISH, ELIMINATE, OR PREVENT SUCH BURDENS?

   - Yes. Existing exchange market surveillance, position limit and position accountability systems have demonstrated that they provide a vigorous and effective system to deter and detect artificial, manipulated prices or attempts at manipulation as well as to address excessive speculation. Position accountability levels are an effective and dynamic market surveillance tool that gives exchanges more flexibility in responding to rapidly changing market conditions and circumstances

3. HOW SHOULD THE COMMISSION EVALUATE THE POTENTIAL EFFECT OF FEDERAL SPECULATIVE POSITION LIMITS ON THE LIQUIDITY, MARKET EFFICIENCY AND PRICE DISCOVERY CAPABILITIES OF REFERENCED ENERGY CONTRACTS IN DETERMINING WHETHER TO ESTABLISH POSITION LIMITS FOR SUCH CONTRACTS?

   - The imposition of CFTC position limits now would harm the liquidity, market efficiency and price discovery benefits provided by the futures markets. The CFTC currently has no authority to impose limits on OTC swaps or foreign markets; consequently, any purported benefit provided by the imposition of position limits would not be realized, leaving, as the real effect of such imposition, the many harmful costs resulting from driving existing futures business to these currently unregulated markets. The CFTC should defer action on the Proposal until after Congress has acted.

4. UNDER THE CLASS APPROACH TO GROUPING CONTRACTS AS DISCUSSED HEREIN, HOW SHOULD CONTRACTS THAT DO NOT CASH SETTLE TO THE PRICE OF A SINGLE CONTRACT, BUT SETTLE TO THE AVERAGE PRICE OF A SUBGROUP OF CONTRACTS WITHIN A CLASS BE TREATED DURING THE SPOT MONTH FOR THE PURPOSES OF ENFORCING THE PROPOSED SPECULATIVE POSITION LIMITS?

   - We do not support the Proposal and we do not believe that Federal position limits are necessary for energy commodities. With regard to our own contracts and procedures, at present, it does not appear that we have any contracts that are financially settled to the average price of a subgroup of contracts within a class. However, our general approach is to average contracts for position limit purposes. Specifically, where a contract is essentially an average of a number of other contracts, we would endeavor where practicable to split up open positions by a participant in that contract and apportion them to the subgroup of contracts being averaged based on the weighting of each such contract as a component of that average. However, if a large number of contracts is reflected in an average or an index, such as the S&P 500 futures contract, we would not look to split up the open positions for surveillance purposes into such fractionalized splits of the open positions being held.

5. UNDER PROPOSED REGULATION 151.2(B)(1)(I), THE COMMISSION WOULD ESTABLISH AN ALL-MONTHS-COMBINED AGGREGATE POSITION LIMIT EQUAL TO 10% OF THE AVERAGE COMBINED FUTURES AND OPTION CONTRACT OPEN INTEREST AGGREGATED ACROSS ALL REPORTING MARKETS FOR THE MOST RECENT CALENDAR YEAR UP TO 25,000 CONTRACTS, WITH A MARGINAL INCREASE OF 2.5% OF OPEN INTEREST THEREAFTER. *AS AN ALTERNATIVE TO THIS APPROACH TO AN ALL-MONTHS-COMBINED AGGREGATE POSITION LIMIT, THE COMMISSION REQUESTS COMMENT ON WHETHER AN ADDITIONAL INCREMENT WITH A MARGINAL INCREASE LARGER THAN 2.5% WOULD BE ADEQUATE TO PREVENT EXCESSIVE SPECULATION IN THE REFERENCED ENERGY CONTRACTS.* AN ADDITIONAL INCREMENT WOULD PERMIT TRADERS TO HOLD LARGER POSITIONS RELATIVE TO TOTAL OPEN POSITIONS IN THE REFERENCED ENERGY CONTRACTS, IN COMPARISON TO THE PROPOSED FORMULA. FOR EXAMPLE, THE COMMISSION COULD FIX THE ALL-MONTHS-COMBINED AGGREGATE POSITION LIMIT AT 10% OF THE PRIOR YEAR'S AVERAGE OPEN INTEREST UP TO 25,000 CONTRACTS, WITH A MARGINAL INCREASE OF 5% UP TO 300,000 CONTRACTS AND A MARGINAL INCREASE OF 2.5% THEREAFTER. ASSUMING THE PRIOR YEAR'S AVERAGE OPEN INTEREST EQUALED 300,000 CONTRACTS, AN ALL-MONTHS-COMBINED AGGREGATE POSITION LIMIT WOULD BE FIXED AT 9,400 CONTRACTS UNDER THE PROPOSED RULE AND 16,300 CONTRACTS UNDER THE ALTERNATIVE.

- We do not believe that excessive speculation, as that term is used in Section 4a, can presently be identified for the four referenced energy commodities in the Proposal. We also do not believe the proposed limits are necessary to prevent excessive speculation in energy commodities.

- Upon the grant by Congress of new OTC authority to the CFTC, a revised version of the Proposal necessarily would extend to specified contracts in the bilateral OTC venue. Thus, it is reasonable to anticipate that such a revised version of the Proposal likely could include limits that are higher than those proposed, and such higher overall aggregate limits presumably could thereby have less harmful impact on market liquidity and price discovery. That stated, it must be noted that the statutory test that must be met under Section 4a is whether the limits are "necessary", whereas this question merely asks whether a higher limit would be "adequate", which would seem to be a lesser standard than the necessary statutory finding.

6. SHOULD CUSTOMARY POSITION SIZES HELD BY SPECULATIVE TRADERS BE A FACTOR IN MODERATING THE LIMIT LEVELS PROPOSED BY THE COMMISSION? IN THIS CONNECTION, THE COMMISSION NOTES THAT CURRENT REGULATION 150.5(C) STATES CONTRACT MARKETS MAY ADJUST THEIR SPECULATIVE LIMIT LEVELS "BASED ON POSITION SIZES CUSTOMARILY HELD BY SPECULATIVE TRADERS ON THE CONTRACT MARKET, WHICH SHALL NOT BE EXTRAORDINARILY LARGE RELATIVE TO TOTAL OPEN POSITIONS IN THE CONTRACT * * * *"

   - We do not support the Proposal and we do not believe that Federal position limits are necessary for energy commodities. We note that CFTC Regulation 150.5(c) does provide contract markets with flexibility to take into account customary positions for speculators as a factor in administering existing limits. At the exchange level, we believe that it is reasonable to take customary position sizes into consideration in the application of our own monitoring programs. However, while this can be a consideration, in our view, the predominant consideration for an exchange still remains the possible influence that a position of that size may have on the applicable contract month in light of all other information about positions in that contract month. In other words, concentration analysis will continue to serve as our primary focus.

7. REPORTING MARKETS THAT LIST REFERENCED ENERGY CONTRACTS, AS DEFINED BY THE PROPOSED REGULATIONS, WOULD CONTINUE TO BE RESPONSIBLE FOR MAINTAINING THEIR OWN POSITION LIMITS (SO LONG AS THEY ARE NOT HIGHER THAN THE LIMITS FIXED BY THE COMMISSION) OR POSITION ACCOUNTABILITY RULES. THE COMMISSION SEEKS COMMENT ON WHETHER IT SHOULD ISSUE ACCEPTABLE PRACTICES THAT ADOPT FORMAL GUIDELINES AND PROCEDURES FOR IMPLEMENTING POSITION ACCOUNTABILITY RULES.

- As noted, we do not support the Proposal, we do not believe that Federal position limits are necessary for energy commodities, and we similarly do not see a need for acceptable practices. More fundamentally, we believe that the limits should be set and exemptions should be granted at the exchange level and reporting markets generally thus should be accorded the greatest possible flexibility to monitor and enforce the position limits applicable to their markets. As established DCMs, we have the most direct exposure in monitoring our markets and thus we believe the most prudent regulatory approach is to provide us with the flexibility to choose actions as we deem necessary.

8. PROPOSED REGULATION 151.3(A)(2) WOULD ESTABLISH A SWAP DEALER RISK MANAGEMENT EXEMPTION WHEREBY SWAP DEALERS WOULD BE GRANTED A POSITION LIMIT EXEMPTION FOR POSITIONS THAT ARE HELD TO OFFSET RISKS ASSOCIATED WITH CUSTOMER INITIATED SWAP AGREEMENTS THAT ARE LINKED TO A REFERENCED ENERGY CONTRACT BUT THAT DO NOT QUALIFY AS *BONA FIDE* HEDGE POSITIONS. THE SWAP DEALER RISK MANAGEMENT EXEMPTION WOULD BE CAPPED AT TWICE THE SIZE OF ANY OTHERWISE APPLICABLE ALL-MONTHS-COMBINED OR SINGLE NON-SPOT-MONTH POSITION LIMIT. THE COMMISSION SEEKS COMMENT ON ANY ALTERNATIVES TO THIS PROPOSED APPROACH. THE COMMISSION SEEKS PARTICULAR COMMENT ON THE FEASIBILITY OF A "LOOK-THROUGH" EXEMPTION FOR SWAP DEALERS SUCH THAT DEALERS WOULD RECEIVE EXEMPTIONS FOR POSITIONS OFFSETTING RISKS RESULTING FROM SWAP AGREEMENTS OPPOSITE COUNTERPARTIES WHO WOULD HAVE BEEN ENTITLED TO A HEDGE EXEMPTION IF THEY HAD HEDGED THEIR EXPOSURE DIRECTLY IN THE FUTURES MARKETS. HOW VIABLE IS SUCH AN APPROACH GIVEN THE COMMISSION'S LACK OF REGULATORY AUTHORITY OVER THE OTC SWAP MARKETS?

    - Once again, we do not support the Proposal and we do not believe that Federal position limits are necessary for energy commodities. As to a possible look-through exemption, it is our sense that this effort would involve a considerable commitment of time and resources by CFTC staff and by the swap dealer community.

9. PROPOSED REGULATION 20.02 WOULD REQUIRE SWAP DEALERS TO FILE WITH THE COMMISSION CERTAIN INFORMATION IN CONNECTION WITH THEIR RISK MANAGEMENT EXEMPTIONS TO ENSURE THAT THE COMMISSION CAN ADEQUATELY ASSESS THEIR NEED FOR AN EXEMPTION. THE COMMISSION INVITES COMMENT ON WHETHER THESE REQUIREMENTS ARE SUFFICIENT. IN THE ALTERNATIVE, SHOULD THE COMMISSION LIMIT THESE FILING REQUIREMENTS, AND INSTEAD RELY UPON ITS REGULATION 18.05 SPECIAL CALL AUTHORITY TO ASSESS THE MERIT OF SWAP DEALER RISK MANAGEMENT EXEMPTION REQUESTS?

    - We do not support the Proposal and we do not believe that Federal position limits are necessary for energy commodities. However, as a matter of best practices on regulatory process, we believe that this information is best identified in a rule-making process providing opportunity for notice and comment. We do not believe regular use of the CFTC's special call authority to obtain information on exemption requests is the preferred regulatory practice.

10. THE COMMISSION'S PROPOSED PART 151 REGULATIONS FOR REFERENCED ENERGY CONTRACTS WOULD SET FORTH A COMPREHENSIVE REGIME OF POSITION LIMIT, EXEMPTION AND AGGREGATION REQUIREMENTS THAT WOULD OPERATE SEPARATELY FROM THE CURRENT POSITION LIMIT, EXEMPTION AND AGGREGATION REQUIREMENTS FOR AGRICULTURAL CONTRACTS SET FORTH IN PART 150 OF THE COMMISSION'S REGULATIONS. WHILE PROPOSED PART 151 BORROWS MANY FEATURES OF PART 150, THERE ARE NOTABLE DISTINCTIONS BETWEEN THE TWO, INCLUDING THEIR METHODS OF POSITION LIMIT CALCULATION AND TREATMENT OF POSITIONS HELD BY SWAP DEALERS. THE COMMISSION SEEKS COMMENT ON WHAT, IF ANY, OF THE DISTINCTIVE FEATURES OF THE POSITION LIMIT FRAMEWORK PROPOSED HEREIN, SUCH AS AGGREGATE POSITION LIMITS AND THE SWAP DEALER LIMITED RISK MANAGEMENT EXEMPTION, SHOULD BE APPLIED TO THE AGRICULTURAL COMMODITIES LISTED IN PART 150 OF THE COMMISSION'S REGULATIONS.

    - We believe that the more appropriate policy approach would be to apply more of the position limit framework used for agricultural commodities to energy products, rather than the counter approach as suggested by this question. As stated in our White Paper, we favor use of the aggregation of ownership approach contained in Part 150 of the CFTC's regulations. The Proposal did not identify, and we are otherwise not aware of, any policy basis for the CFTC to impose disparate standards for agriculture and energy. Consequently, we believe the Commission should follow its agricultural position limit policies for aggregation and risk management exemption in the energy area.

11. THE COMMISSION IS CONSIDERING ESTABLISHING SPECULATIVE POSITION LIMITS FOR CONTRACTS BASED ON OTHER PHYSICAL COMMODITIES WITH FINITE SUPPLY SUCH AS PRECIOUS METAL AND SOFT AGRICULTURAL COMMODITY CONTRACTS. THE COMMISSION INVITES COMMENT ON WHICH ASPECTS OF THE CURRENT SPECULATIVE POSITION LIMIT FRAMEWORK FOR THE AGRICULTURAL COMMODITY CONTRACTS AND THE FRAMEWORK PROPOSED HEREIN FOR THE MAJOR ENERGY COMMODITY CONTRACTS (SUCH AS PROPOSED POSITION LIMITS BASED ON A PERCENTAGE OF OPEN INTEREST AND THE PROPOSED EXEMPTIONS FROM THE SPECULATIVE POSITION LIMITS) ARE MOST RELEVANT TO CONTRACTS BASED ON OTHER PHYSICAL COMMODITIES WITH FINITE SUPPLY SUCH AS PRECIOUS METAL AND SOFT AGRICULTURAL COMMODITY CONTRACTS.

    - For the reasons stated above, we believe any new Federally set position limits are premature and would harm the public interest if adopted at this time. We also believe that the case has yet to be made that such new Federal limits are "necessary" as required by the statute either for energy products or for other commodities such as precious metal and soft agricultural commodities.

- As we have consistently stated, with the grant of broader authority that allows the CFTC to aggregate across all applicable venues, we favor the independent account controller aggregation exemption available for agricultural commodities. In addition, as detailed in our letter, we do not support carving out a new and more restrictive risk management exemptions for swap dealers and providing no form of exemption for index and exchange-traded funds.

12. AS DISCUSSED PREVIOUSLY, THE COMMISSION HAS FOLLOWED A POLICY SINCE 2008 OF CONDITIONING FBOT NO-ACTION RELIEF ON THE REQUIREMENT THAT FBOTS WITH CONTRACTS THAT LINK TO CFTC-REGULATED CONTRACTS HAVE POSITION LIMITS THAT ARE COMPARABLE TO THE POSITION LIMITS APPLICABLE TO CFTC-REGULATED CONTRACTS. IF THE COMMISSION ADOPTS THE PROPOSED RULEMAKING, SHOULD IT CONTINUE, OR MODIFY IN ANY WAY, THIS POLICY TO ADDRESS FBOT CONTRACTS THAT WOULD BE LINKED TO ANY REFERENCED ENERGY CONTRACT AS DEFINED BY THE PROPOSED REGULATIONS?

- The current policy applies when an FBOT proposes to offer "direct access" to U.S. traders to a contract that is linked to or based upon the settlement price of a contract traded on a DCM. We support new CFTC statutory authority that provides the CFTC with appropriate authority over foreign boards of trade.

13. THE COMMISSION NOTES THAT CONGRESS IS CURRENTLY CONSIDERING LEGISLATION THAT WOULD REVISE THE COMMISSION'S SECTION 4A(A) POSITION LIMIT AUTHORITY TO EXTEND BEYOND POSITIONS IN REPORTING MARKET CONTRACTS TO REACH POSITIONS IN OTC DERIVATIVE INSTRUMENTS AND FBOT CONTRACTS. UNDER SOME OF THESE REVISIONS, THE COMMISSION WOULD BE AUTHORIZED TO SET LIMITS FOR POSITIONS HELD IN OTC DERIVATIVE INSTRUMENTS AND FBOT CONTRACTS. THE COMMISSION SEEKS COMMENT ON HOW IT SHOULD TAKE THIS PENDING LEGISLATION INTO ACCOUNT IN PROPOSING FEDERAL SPECULATIVE POSITION LIMITS.

- In view of pending legislation in Congress that is expected to provide the CFTC with broader authority over additional OTC venues, including with respect to the setting of position limits, we would urge the Commission to defer further action on the Proposal until the legislative process has been completed.

14. UNDER PROPOSED REGULATION 151.2, THE COMMISSION WOULD SET SPOT-MONTH AND ALL-MONTHS-COMBINED POSITION LIMITS ANNUALLY.

a. Should spot-month position limits be set on a more frequent basis given the potential for disruptions in deliverable supplies for referenced energy contracts?
   - As emphasized throughout our comment letter, we believe that the best approach for setting position limits, including spot month limits, is for the limits to be established by the exchanges in close consultation with Commission staff.

b. Should the Commission establish, by using a rolling-average of open interest instead of a simple average for example, all months-combined position limits on a more frequent basis? If so, what reasons would support such action?
   - We do not support the Proposal and we do not believe that Federal position limits are necessary for energy commodities. As a note, at the exchange level, historically we have tried to avoid changing position levels so frequently out of concern that the markets could be destabilized by injecting uncertainty. Congress has addressed a related issue and advised the CFTC against changing contract terms and other trading conditions for contracts with open interest. The CFTC should respect the need by all traders for legal certainty when they establish positions in deferred months.

15. CONCERNS HAVE BEEN RAISED ABOUT THE IMPACT OF LARGE, PASSIVE, AND UNLEVERAGED LONG-ONLY POSITIONS ON THE FUTURES MARKETS. INSTEAD OF USING THE FUTURES MARKETS FOR RISK TRANSFERENCE, TRADERS THAT OWN SUCH POSITIONS TREAT COMMODITY FUTURES CONTRACTS AS DISTINCT ASSETS THAT CAN BE HELD FOR AN APPRECIABLE DURATION. THIS NOTICE OF RULEMAKING DOES NOT PROPOSE REGULATIONS THAT WOULD CATEGORIZE SUCH POSITIONS FOR THE PURPOSE OF APPLYING DIFFERENT REGULATORY STANDARDS. RATHER, THE OWNERS OF SUCH POSITIONS ARE TREATED AS OTHER INVESTORS THAT WOULD BE SUBJECT TO THE PROPOSED SPECULATIVE POSITION LIMITS.

a. Should the Commission propose regulations to limit the positions of passive long traders?
   - No. As we noted in our White Paper and as previously stated in this letter, there is no serious evidence that has been introduced to date in the public discussion against index traders.

b. If so, what criteria should the Commission employ to identify and define such traders and positions?

c. Assuming that passive long traders can properly be identified and defined, how and to what extent should the Commission limit their participation in the futures markets?
   - Their participation should not be limited absent clear and convincing evidence that they somehow have a negative impact on the price discovery process.

d. If passive long positions should be limited in the aggregate, would it be feasible for the Commission to apportion market space amongst various traders that wish to establish passive long positions?
   - No. We do not believe that this approach would be feasible.

e. What unintended consequences are likely to result from the Commission's implementation of passive long position limits?
- By removing the liquidity provided by such investors, we believe that price discovery will be harmed. Hedging in deferred months would become more expensive. Index funds could buy and hold physicals. That could artificially impact prices and the CFTC would have caused that harm inadvertently.

16. THE PROPOSED DEFINITION OF REFERENCED ENERGY CONTRACTS, DIVERSIFIED COMMODITY INDEX, AND CONTRACTS OF THE SAME CLASS ARE INTENDED TO BE SIMPLE DEFINITIONS THAT READILY IDENTIFY THE AFFECTED CONTRACTS TRHOUGH AN OBJECTIVE AND ADMINISTERIAL PROCESS WITHOUT RELYING ON THE COMMISSION'S EXERCISE OF DISCRETION.

a. Is the proposed definition of contracts of the same class for spot and non-spot month sufficiently inclusive?
- Although we do not support the Proposal and we do not believe that Federal position limits are necessary for energy commodities, we do not have a specific issue with this definition.

b. Is it appropriate to define contracts of the same class during spot months to only include contracts that expire on the same day?
- We find this to be a reasonable approach.

c. Should diversified commodity indexes be defined with greater particularity?
- As noted in the responses to other questions, we do not support the Proposal and we do not believe that Federal position limits are necessary for energy commodities and have no comment on the current proposed definition.

17. UNDER THE PROPOSED REGULATIONS, A SWAP DEALER SEEKING A RISK MANAGEMENT EXEMPTION WOULD APPLY DIRECTLY TO THE COMMISSION FOR THE EXEMPTION. SHOULD SUCH EXEMPTIONS BE PROCESSED BY THE REPORTING MARKETS AS WOULD BE THE CASE WITH *BONA FIDE* HEDGE EXEMPTIONS UNDER THE PROPOSED REGULATIONS?

- Exemption processes in general should continue to be processed by the reporting markets, which are in the best position to assess such exemptions and as appropriate grant exemptions that are tailored in quantity and duration.

18. IN IMPLEMENTING INITIAL SPOT-MONTH SPECULATIVE POSITION LIMITS, IF THE NOTICE OF PROPOSED RULEMAKING IS FINALIZED, SHOULD THE COMMISSION:

a. Issue special calls for information to the reporting markets to assess the size of a contract's deliverable supply;

b. Use the levels that are currently used by the exchanges; or
c. Undertake an independent calculation of deliverable supply without substantial reliance on exchange estimates?

- Once again, we do not support the Proposal and we do not believe that Federal position limits are necessary for energy commodities. As a note, we believe that exchanges have demonstrated the expertise that they have developed over time in assessing the markets underlying their listed contracts.