



Alternative Investment Management Association

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

Submitted via to agswapsANPR@cftc.gov

28 October 2010

Dear Mr Stawick,

Agricultural Swaps

The Alternative Investment Management Association ('AIMA')¹ appreciates the Commodity Futures Trading Commission's (the 'Commission') invitation to provide comment on the provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the 'Dodd-Frank Act') and specifically the rule-making required by section 723(c)(3) of the Dodd-Frank Act. As the trade association for the global hedge fund industry, we would like to share our views on both the questions posed in the advanced notice of proposed rulemaking and request for comment and comment more generally on the policy arguments for maintaining an open, efficient and well functioning market in agricultural commodities.

Although we are not aware of specific investments made by funds managed by AIMA's members, to the extent that our members are involved in agricultural swap trading, we would argue for the continuance of a workable, open market that provides sufficient transparency to market regulators and, where appropriate, the market and one which gives adequate protections to trading counterparties, investors, end-users and producers.

We set out below our general comments on the regulation of agricultural commodities and in the annex to this letter we set out our responses to the specific questions posed by the Commission.

AIMA's comments

Regulating agricultural commodities

The Dodd-Frank Act at section 723(c)(3) provides that swaps in an "agricultural commodity" are prohibited unless entered into pursuant to a rule, regulation or order of the Commission adopted pursuant to section 4(c) of the Commodity Exchange Act (CEA). The Commission may only apply a section 4(c) exemption if it would be consistent with the public interest, it would apply only to "appropriate persons" and it would not affect the Commission's ability, or a designated contract market's (DCM) ability, to discharge its regulatory or self-regulatory duties under the CEA.

We understand that there are particular concerns regarding market manipulation and other types of abusive behaviour in the agricultural commodities market, which has traditionally seen agricultural swaps subject to a specific regulatory regime (unlike other commodity swaps). Such concerns warrant attention as agricultural markets provide an important means for agricultural producers (e.g. farmers) to sell their produce to end-users (e.g. manufacturers, and ultimately consumers). Market abuse can be mitigated to a large extent by proper and thorough market oversight, enforcement and penalties. Like the Dodd-Frank Act, previous legislation has increased the Commission's powers to oversee the market, take enforcement action and otherwise deter market

¹ AIMA is the trade body for the hedge fund industry globally; our membership represents all constituencies within the sector - including hedge fund managers, fund of hedge funds managers, prime brokers, fund administrators, accountants and lawyers. Our membership comprises over 1,200 corporate bodies in 45 countries, with 11% based in the US and over 30% of AIMA members' total assets under management (AUM) managed by US investment advisers.

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abuse, and we fully support it in its role. We believe that additional transparency in the swaps market (as provided in the Dodd-Frank Act) and regular and detailed reporting of trades to the Commission will provide the regulator with all the information it needs to identify, deter and prosecute abuses of the market. Therefore, there is no need for a specific regime for agricultural swaps, and multiple regimes risks creating arbitrage opportunities.

Choices of trading venue

AIMA believes that parties who wish to transact in any market should be free to choose the most appropriate method of transacting for them, be that trading on organised multilateral trading venues such as DCMs or trading through personally negotiated contracts ('over-the-counter' or 'OTC' trading), or any other method available in the market. Whilst historically the OTC swaps market has been seen as more opaque, the amendments to the CEA and other legislation provided for by the Dodd-Frank Act (and as mandated for all G20 countries by the leaders of the G20 nations following the 2009 Pittsburgh Summit) fully address those concerns.

The futures and options agricultural markets are important for both producers and end-users as they allow producers to find willing buyers of their commodities and for end-users to seek stable prices for the production of goods using such commodities. Financial intermediaries and investors provide important liquidity to the market, ensuring that producers can sell their commodities and manufacturers can buy them as and when they require them. Producers, particularly, rely on the futures and (to a lesser extent) options markets to hedge the cost of price volatility in the market caused by factors relevant to the underlying supply and demand for a commodity, and without which hedging capability it would be difficult to do business. While organised multilateral futures markets which market participants do trade on are useful, these do not always offer the flexibility and range of products of the off-exchange swaps markets. For example, certain types of agricultural commodities do not sell in large enough quantities or are not liquid enough to be profitably listed on exchanges, so that parties must trade via swaps contracts. Additionally, the required fungibility of exchange-traded contracts means they are limited as to the range of terms that may be offered, so that a swap contract may be necessary to allow the contracting parties to trade on terms which suit both parties' business needs.

Therefore, as there is good and valid reason for maintaining an agricultural swaps market, and as new rules for the swap markets more generally have been introduced by the Dodd-Frank Act which will address concerns about manipulation and market abuse, we believe that there is no need to impose any additional and specific requirements on agricultural commodity swaps.

Central clearing

AIMA is supportive of the requirement to clear eligible contracts with derivative clearing organisations (DCOs) as required by the Dodd-Frank Act. We believe that it is probable that many agricultural swap contracts will continue to be able to be traded OTC (for the reasons given above), although be suitable for central clearing. Central clearing provides a strong mechanism to protect users of the market from failed trades and credit risk from their counterparties, and to the extent that it is suitable for specific types of agricultural swaps contracts, we believe the mandatory clearing obligation should apply. We suggest that each specific type of agricultural swap should be assessed individually and with particularity to ensure that it is suitable for central clearing and that the Commission should not seek to impose a 'blanket' obligation for all agricultural swaps to be centrally cleared.

Position limits

We understand that the Commission is required by the Dodd-Frank Act to impose position limits on markets trading certain physical commodities (i.e. 'exempt commodities' (e.g. energy and metals) and 'agricultural commodities' as defined in the CEA), for the purposes of avoiding large stakes in individual markets being taken by parties, causing price volatility. Although we believe that such position limits are unnecessary and do not achieve such a purpose (we intend to comment separately on the position limit provisions), to the extent that the Commission is required to impose such limits, we understand that it is important and necessary to define clearly the scope of the term 'agricultural commodities'.

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The definition of 'agricultural swaps'

In defining 'agricultural swaps', our main concern is for clarity as to which products any rules governing agricultural swaps apply. We understand the difficulty in defining agricultural commodities: it is not difficult to say which product definitely does and does not fall within the definition but there are also considerable 'grey areas', lacking clarity. A clear set of rules which seek to address those grey areas, together with guidance and non-exhaustive lists of products, would be very useful to the industry.

Conclusion

We thank you for this opportunity to comment on this important provision of the Dodd-Frank Act and we are, of course, very happy to discuss with you in greater detail any of our comments.

Yours sincerely,

Mary Richardson
Director of Regulatory & Tax Department

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Annex 1

Current Agricultural Swaps Business	
1. How big is the current agricultural swaps business—including both agricultural swaps trading under current part 35 and ATOs under §§ 32.4 and 32.13(g) of the Commission’s regulations?	
	The nature of the current swaps market makes accurate calculation or estimation of the amount of agricultural swaps trading under current part 35 and ATOs difficult. AIMA does not have any data available regarding its membership’s trading activity, nor do we possess wider market statistics.
2. What types of entities are participating in the current agricultural swaps business?	
	AIMA does not have available statistics about the size of our members’ aggregated business in agricultural trades, although we do not believe that trading in agricultural commodities forms either a substantial part of our members’ trading strategies or that our members form a substantial portion of the total market in agricultural swaps.
3. Are agricultural swaps/ATO participants significantly different than the types of entities participating in other physical commodity swaps/trade options?	
	We do not believe that there are, for any practical purposes, meaningful differences between the participants in the agricultural swap markets (including options) and participants in other physical commodity markets.
Agricultural Swaps Clearing	
4. What percentage of existing agricultural swaps trading is cleared vs. non-cleared?	
	AIMA does not have such data available. However, if the Commission is able to estimate the size of the agricultural swaps market, calculation of the percentage which is subject to central clearing should be easily found by requesting data from the small number of clearing houses to which the Commission has granted permission to clear agricultural swaps.
5. What percentage of existing agricultural swaps would be eligible for the commercial end-user exemption from the mandatory clearing requirement?	
	AIMA is not able to contribute data on this question.
6. What percentage of trading would be subject to the Dodd-Frank clearing requirement, if that requirement applied automatically to agricultural swaps (other than those eligible for the commercial end-user exemption)?	
	<p>AIMA is not aware of the percentage of the agricultural swap market which is or could be subject to a commercial end-user exemption. However, as stated above, we do not believe that blanket mandated clearing for all agricultural swaps would be suitable for the market; many markets in particular agricultural commodities are small and transactions specifically tailored, so that there may be unintended consequences of forcing (unsuitable) clearing, including increased risk levels at clearing houses and increased financial stability risks for these important market infrastructure institutions.</p> <p>If only suitable agricultural swap contracts were subject to the obligation (and we would expect them to be the vast majority), the percentage or number of agricultural swap trades that would be subject to the clearing requirement will depend on the how criteria in section 2(h) of the CEA (as inserted by the Dodd-</p>

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Frank Act) are interpreted, and the outcome of the 30-day public consultations which the Commission is required to undertake when mandating the clearing of any class of swap. Such a figure is impossible to predict at this early stage.

7. What would be the practical and economic effect of a rule requiring agricultural swaps transactions (other than those eligible for the commercial end-user exemption) generally to be cleared? The Commission is interested in the views of agricultural swaps market participants (both users and swap dealers) regarding a potential clearing requirement for agricultural swaps.

We believe that any agricultural swaps subject to clearing should be cleared under the regime established by the Dodd-Frank Act. See our answer to question 8 below.

8. What would be the practical and economic effect of requiring agricultural swaps to be cleared under the Dodd- Frank clearing regime?

We believe that, generally, the requirement to have agricultural swaps subject to the clearing obligation will be largely positive. Clearing has many benefits beyond the main goal of reducing systemic risk through mitigation of credit risk, by having buyers and sellers transact with one, well-funded, heavily supervised and highly capitalised central counterparty ('CCP') which will be significant in terms of benefits. Clearing requires improved use of confirmation systems so that terms of trade are made clear immediately after execution, resulting in fewer trading errors. Clearing allows some degree of straight-through processing, so that the time between execution and confirmation of terms and trade (and then, exchange of collateral) can be reduced; that is important, so that parties can be immediately aware where their exposures lie and with which counterparty. Clearing, under the Dodd-Frank Act, will also require parties to exchange appropriate levels of collateral in the form of segregated high-quality initial and variation margin, serving to reduce credit risk further and to spread risk through the failure of single large counterparties. Although reporting is required for uncleared swaps, the data that CCPs will have available and will be able to report - to both the counterparties and the market regulators - will ensure that levels of transparency are improved significantly. In summary, the practical benefits will be the speed and efficiencies of the system and there will be beneficial economic effect in the reduction of risk both to counterparties and to the financial system and reduced market (price) volatility.

However, as we note above, requiring unsuitable contracts to be cleared will increase rather than reduce risk in the financial system. A CCP uses various risk-mitigation techniques to off-set the risk it takes on as a counterparty to each trade, the techniques including hedging and the calculation of appropriate collateral levels. If a contract is highly 'bespoke', it cannot be effectively managed by a CCP; it is not possible to calculate appropriate margin levels and it is not possible to find appropriate 'hedges'. The result is that the risk of failure is merely transferred to a large CCP institution, and it is highly undesirable that it would be required to take on unmanageable risk.

Trading

9. Have current agricultural swaps/ ATO participants experienced any significant trading problems, including: (a) economic problems (i.e., contracts not providing an effective hedging mechanism, or otherwise not performing as expected); (b) fraud or other types of abuse; or (c) difficulty gaining access to the agricultural swaps market?

AIMA is not aware of any specific examples of significant trading problems experienced by agricultural swap participants or ATO participants.

Agricultural Swaps Purchasers

10. Do agricultural swaps/ATO purchasers need more protections than commodity swaps/trade options?

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<p>We do not believe there is a case for additional protections for such end users. Rather, end user protection should be the same as for other commodity swaps/trade options.</p>
11. If so, why, and what should those protections be?
N/A
12. Would additional protections for agricultural swaps purchasers unduly restrict their risk management opportunities?
Yes; we believe that additional protections are unnecessary and unfair and, if any were implemented in an overly restrictive manner, may unduly affect the ability of producers, manufacturers and other users in the market to hedge risk through the use of agricultural swaps.
13. Should the Commission consider rules to make it easier for agricultural producers to participate in agricultural swaps—for example, by allowing producers who do not qualify as ECPs to purchase agricultural swaps?
Yes. The current definition of an 'ECP' should be reviewed to include agricultural producers in the agricultural swaps market, who are currently either unable to participate in the market or who must do so through intermediaries that are ECPs. The ECP definition does create a barrier to a market for smaller retail investors and other participants, who are either not sufficiently sophisticated to safely participate or who are too small and, therefore, vulnerable to substantial and unmanageable losses through trading in the markets. The Commission should review such criteria against current demand for non-ECP participants wishing to purchase agricultural swaps, the advantages of their participation and the overall effect that their participation may have on the market.
Designated Contract Markets
14. Should agricultural swaps transactions be permitted to trade on DCMs to the same extent as all other swaps are permitted on DCMs?
Yes; we believe that such swaps transactions should be permitted to trade on DCMs to the same extent as all other swaps.
15. If yes, why?
We do not believe that there are any reasons to distinguish between agricultural swaps and other commodity swaps for this purpose. If a contract is traded in sufficient volumes, is sufficiently liquid and is fungible enough (in both economic and trade terms), then there is benefit for the market in such contracts being traded on DCMs, including transparency benefits. An assessment of a contract's suitability for trading on DCMs must be undertaken before it is admitted to trading, to ensure the contract can be successfully traded in this way. The admission to trading on a DCM should not preclude the ability for contracts, where necessary, to be traded and executed via other methods or on other trading venues.
16. If no, what other requirements, conditions or limitations should apply?
We do not believe that any additional requirements, conditions or limitations should apply. In particular, we believe that the imposition of position limits may negatively affect price discovery and liquidity of contracts, rather than assist towards such goals.

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Swap Execution Facilities	
17. Should agricultural swaps transactions be permitted on SEFs to the same extent as all other swaps are permitted to transact on SEFs?	
	Yes; we believe that such swaps transactions should be permitted to trade on SEFs to the same extent as all other appropriate swaps are permitted or required to do so.
18. If yes, why?	<p>The concept of a SEF is new in the Dodd-Frank Act and the consequent amendment to the CEA to include the term 'swap execution facility' defines it as: "a trading system or platform in which multiple participants have the ability to execute or trade swaps by accepting bids and offers made by multiple participants in the facility or system, through any means of interstate commerce, including any trading facility, that (A) facilitates the execution of swaps between persons; and (B) is not a designated contract market".</p> <p>We believe that the introduction of SEFs offers an opportunity for further competition in the choice of trading and execution venue. We also believe that some agricultural swap contracts may be suitable and benefit from trading on both DCMs and SEFs. It remains to be seen which features SEFs will adopt, and we believe that the debate surrounding their establishment is still on-going and subject to further rule-making by both the Commission and the Securities and Exchange Commission ('SEC'). Therefore, we suggest that once the definitions are made clearer, in terms of what a SEF will be and its rules, the Commission then assess whether SEFs are subject to sufficient rules, oversight, systems and controls and other protections to allow agricultural swaps to trade on them. We would not anticipate that they would become any less appropriate than for other types of swaps traded on SEFs.</p>
19. If no, what other requirements, conditions or limitations should apply?	
	As above, we believe that appropriate requirements, conditions or limitations should depend on the actual form of the SEF, which has yet to be decided and is subject to consultation by the Commission and the SEC.
Trading Outside of DCMs and SEFs	
20. Should agricultural swaps be permitted to trade outside of a DCM or SEF to the same extent as all other swaps?	
	Yes.
21. If yes, why?	<p>As discussed above with regards to DCMs and SEFs, we believe that parties should have the choice of appropriate trading and execution venues, and should be able to transact in any manner that suits their specific requirements. If the contracts are traded outside DCMs and SEFs, we believe that the market participants should be subject to the same oversight and the same basic protections against fraud and market abuse as with other swaps traded outside DCMs and SEFs.</p>
22. If no, what other requirements, conditions or limitations should apply?	
	N/A
23. Should agricultural swaps be permitted to trade outside of a DCM or SEF to a different extent than other swaps due to the nature of the products and/or participants in the agricultural swaps market?	
	No; we believe that agricultural swaps should be permitted to trade to the same extent as other swaps.

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24. In general, should agricultural swaps be treated like all other physical commodity swaps under Dodd-Frank?

Yes.

25. If yes, why?

As stated above, we do not believe that the features of, or participants in, the agricultural swaps market necessitate any special treatment.

26. If no, are there any additional requirements, conditions or limitations not already discussed in other answers that should apply?

As above.

27. If agricultural swaps are generally treated like swaps in other physical commodities, are there specific agricultural commodities that would require special or different protections?

We do not believe any specific agricultural commodities warrant special treatment or greater protection than others, although as previously discussed there will be contracts that do not trade as frequently or trade in much lower volumes, with smaller contract sizes and more tailored terms and, therefore, they may not be suitable to trade on DCMs or SEFs, or they may be not be suitable for central clearing. If there are specific commodities for which the Commission believes there may be additional threats of fraud or market manipulation, we suggest that the Commission should arrange resources internally to ensure that greater inspection and enforcement action takes place in such market.

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