



G R E S H A M I N V E S T M E N T M A N A G E M E N T L L C

Dr. Henry G. Jarecki  
*Chairman*

February 14, 2011

David A. Stawick  
Secretary  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21<sup>st</sup> Street, NW  
Washington, DC 20581

Re: 17 CFR Parts 1, 150 & 151  
RIN 3038-AD15 & 3038-AD16  
Position Limits for Derivates

Dear Mr. Stawick:

Pursuant to the Federal Register Notice of January 26, 2011,<sup>1</sup> pertaining to the Notice of proposed rulemaking for speculative position limits, Gresham Investment Management LLC (Gresham) submits the following comments and recommendations.

**Gresham Investment Management LLC**

Gresham was founded by Dr. Henry Jarecki and has pioneered the management of diversified commodity investment portfolios using commodity futures. Our Tangible Asset Program® (TAP®) began trading in January 1987 and predates both the S&P Goldman Sachs and Dow Jones UBS Commodity Indexes. As of February 2011, Gresham manages in excess of \$12 billion for a variety of clients, including Public and Corporate Pension Funds, Endowments, Corporations, Health Systems, and Sovereign Wealth Funds, based in the Americas, Europe, Asia, and the Middle East.

Gresham assists its clients in investing in commodities to allow them to reduce their risks in their overall portfolios and to help them hedge against inflation. We enable them to invest in long-only, unleveraged, tangible commodity futures portfolios either in accounts they hold with brokers or as participants in commodity pools we manage for them and others together. We do this by:

- Annually choosing the thirty or so commodities which best represent the commodity class of investable assets,
- Managing each client's account or commodity pool to keep it at the proportions they have chosen, and

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<sup>1</sup> FR Vol.76, No.17, pages 4752-4777

- Keeping the investor aware of the positions they have and of their account values.

Since Gresham first began trading in 1987, we have exclusively utilized the safety and transparency of exchange-traded futures to implement our strategies. Long before they invest, our clients are fully aware of what our investment choices will be; it is, then, they, not Gresham, who decide when to enter or exit. Though we view our activity and that of our clients as investment rather than speculation, the Commodity Futures Trading Commission (CFTC) categorizes Gresham as a speculator. Therefore, we are subject to speculative position limits in several of the futures contract markets in which we invest. Further, and equally unfair and inconsistent with our trading, the CFTC aggregates all of the positions we hold for all of our 1,000 clients and thereby unreasonably limits how many positions we can hold and thus how many customers and how much business we can have.

While we are required to function under these unreasonable and constraining limits, our primary competitors, the seven major investment banks, who heretofore have eschewed the transparent futures markets that we utilize, continue to offer their clients highly leveraged, over-the-counter swaps of identical character to ours, but which are not subject to either exchange or Commission regulation. The delays inherent in implementing this proposal allow such highly leveraged market activity to continue until such time as additional data is gathered and analyzed so that no limit on their activity would be in place sooner than some time in the first quarter of 2012. This allows our competitors to utilize the Commission's delay to continue their swaps business as usual, while we remain subject to outdated and inadequate agricultural speculative position limits last increased in 2005, based on 2004 data, when the open interest and the physical and futures prices in the agricultural commodities were at significantly lower levels.

Given the safety and the systematic, transparent, and unleveraged nature of Gresham's commodity investment programs, in 2006, the CFTC issued us a *No Action Letter* granting us limited relief in the form of higher limits. But, despite the fact that we continued to employ our model successfully and without incident throughout the recent credit crisis, our *No Action Letter* was summarily withdrawn in 2009 leaving us in a similar status with the unconstrained and highly leveraged futures traders for whom these limits were no doubt intended. The result puts Gresham's unleveraged customers at a distinct disadvantage to those highly leveraged traders, who pose a continuing systematic risk to the commodity markets.

Therefore, we submit that the proposed regulatory regime for the agricultural contract markets offers no satisfactory relief for our clients, but ironically instead continues to provide preferential treatment to our competitors whose actions the Congress directed the CFTC to bring to light and to regulate.

### **The CFTC Proposal**

Gresham was pleased to hear Chairman Gensler acknowledge that "speculators and hedgers each have a role in the market place" in his response to Congressman

Crawford's question about the role of speculation in the futures markets at the February 10<sup>th</sup>, 2011 meeting of the House Committee on Agriculture. Gresham is concerned, however, that the failure to increase position limits in Agricultural commodity markets to reflect existing open interest and liquidity levels will impair the ability of speculators to fulfill their role of providing liquidity to commercial hedgers. This is of particular concern in light of recent reports such as the one from the National Cotton Council of America stating that U.S. farmers will increase the amount of land dedicated to planting cotton this spring by 14%. This will inevitably lead to a greater need for speculative liquidity by commercial hedgers who will rely on the futures markets to offset the risk of their increased exposure to price changes in Cotton.

Section 4a(a)(3) of the Dodd-Frank Act<sup>2</sup> directs the Commission to set position limit levels that would serve, to the maximum extent practicable, in its discretion:

- (i) to diminish, eliminate, or prevent excessive speculation as described under this section;
- (ii) to deter and prevent market manipulation, squeezes, and corners;
- (iii) to ensure sufficient market liquidity for bona fide hedgers; and
- (iv) to ensure that the price discovery function of the underlying market is not disrupted.

Commissioner Michael Dunn, the senior member of the Commission, in his opening statement at the public hearing on January 13, 2011, in which the proposed rule was approved for publication and comment, noted that:

“With the passage of the Dodd-Frank Act, the CFTC now clearly has a mandate to set position limits on commodity markets and the OTC markets, as appropriate, to diminish, eliminate, or prevent excessive speculation. To date, CFTC staff has been unable to find any reliable economic analysis to support either the contention that excessive speculation is affecting the markets we regulate or that position limits will prevent excessive speculation. The task then is for the CFTC staff to determine whether position limits are appropriate. With such a lack of concrete economic evidence, my fear is that, at best, position limits are a cure for a disease that does not exist or at worst, a placebo for one that does.”

More important, Commissioner Dunn posed, in our view, dispositive questions pertaining to the establishment of speculative position limits.

- Is there more than anecdotal evidence that there is excessive speculation distorting the prices in our markets? If so, we need to see it.
- Is there statistical or economic analysis that shows that excessive speculation exists and that position limits will diminish, eliminate, or prevent it? If so, we need to see it.

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<sup>2</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, 124 Stat.1376 (2010).

- Is there evidence that position limits will lower the price that we pay for gas, milk, and steaks while simultaneously ensuring the integrity of our markets and the price discovery process? If so, we need to see it.

Gresham submits that there is no more than anecdotal evidence and that there is no objective or efficacious economic analysis that position limits would have the desired effect. There is also no convincing evidence that position limits would lower the price of food, fiber, energy, or mineral products. Further, and in accordance with Section 4a(a)(3) of Dodd-Frank, Gresham's exchange trades have always been transparent, have never been excessive or manipulative, and have provided the needed liquidity that is essential for price discovery in the underlying agricultural contract markets in which it has invested on behalf of its clients.

**Given that the Necessary Agricultural Data is Available, the Proposal Creates Unnecessary Delay for the Imposition of Increased Speculative Position Limit on the Agricultural Contracts**

The Commission, pursuant to its authority under Sections 4a(a)(2)(B) and 4a(a)(3) of the Act, is mandated by the Congress to establish position limits for the Designated Contract Markets (DCM) futures and option contracts on the agricultural commodities no later than April 19, 2011.<sup>3</sup> Implicit in that mandate is the intent to promulgate such limits not only for the spot month, but to apply such newly established limits across the board for the spot-month, single-month, and all-months-combined.

In its notice of rulemaking, the Commission proposes to establish the limits in two phases, which would result in multiple phases of implementation and unnecessary delays for the agricultural commodities for which sufficient data is readily available to immediately propose a final rule.

**Spot Month**

The first phase, Regulation 151.4, would impose spot-month position limits only, based on 25 percent of the deliverable supply for a given commodity as determined by the DCM, and adjusted annually. Since that data is available,<sup>4</sup> the spot-month position limits for the agricultural commodities should be re-established for the agricultural commodities by April 19, 2011.

**Single-Month and All-Months-Combined**

In the second phase, the CFTC, inconsistent with all prior regulatory precedent in promulgating federal speculative position limits, would establish so-

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<sup>3</sup> 270 days from July 21, 2010, the effective date of the Act.

<sup>4</sup> Based on the Commission data obtained in the 2008 Special Call, there was minimal swap activity in the agricultural contracts.

called “legacy limits” for the agricultural contracts by setting the single-month and all-months-combined at the current all-months-combined limit. Such an ill-conceived concept is a deviation from the current open interest formula establishing the limit at not more than 10 percent of the open interest of a contract market up to 25,000 contracts, and 2.5 percent thereafter.

Gresham takes strong exception to the Commission’s inexplicable proposal that would insulate the agricultural contracts from the realities of the current market. The Commission is, in effect, proposing to limit appropriate speculative investments to current levels, when new limits should be promptly established to reflect today’s market.

“Legacy limits” would have the effect of impelling essential speculative liquidity to foreign markets thereby threatening to reduce the liquidity in the agricultural contract markets and possibly distorting the price discovery process, an action contrary to the CFTC’s duty to ensure “that markets remain sufficiently liquid so as to afford end users and producers of commodities the ability to hedge commercial risks and to promote efficient price discovery.”<sup>5</sup>

The open interest data strongly argues for the Commission to abandon its “legacy limits” concept and apply the current 10-2.5 percent open interest formula it proposes for the exempt commodities in order to sustain the required liquidity for the agricultural contract markets. Given the 2010 open interest data, the pending Chicago Mercantile Exchange (CME) petition, submitted to the Commission in April 2010, should be updated to reflect the higher open interest. Therefore, we urge that it be applied across the board to all agricultural commodity contract markets.<sup>6</sup>

Further, regarding the pre-publication comments in advance of the Commission’s action referred to in the proposed rule,<sup>7</sup> it is asserted that the speculative activity of “nontraditional” participants in the agricultural contracts could potentially harm the contract performance of “traditional hedgers.” To the contrary, the statistical data<sup>8</sup> evinces that no such possible effect is likely as the data demonstrates that without the participation of “nontraditional(s),” the liquidity available to commercial hedgers is likely to dry up, thereby subjecting the agricultural contract markets to the control of the select large major commercials.

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<sup>5</sup> FR Vol.76, No.17 at page 4755.

<sup>6</sup> See attached Open Interest data.

<sup>7</sup> The National Grain & Feed Association (NGFA) presented the view that the Commission “should use its authority to grant hedge exemptions to financial institutions, index funds, hedge funds or other nontraditional participants in agricultural futures markets extremely sparingly and only if it can be demonstrated clearly that such exemptions will not harm contract performance for traditional hedgers.”

<sup>8</sup> See attached Net Index Positions versus Short Commercial Positions for Wheat, Corn, and Soybeans. The data indicates that commercials build short positions that more than match the net index positions, and indicates that the index positions provide a liquidity multiplier, implying, at least, that if index activity disappeared, the liquidity available to commercials would be significantly impaired.

Further, we would add that the so-called “non traditional” traders have been providing the necessary liquidity to the agricultural markets for some 25-years as acreage, production, and consumption of U.S. agricultural commodities have significantly expanded. Gresham submits that its activity, if anything, has been both traditional and highly beneficial to the commercial market participants.

The U.S. Congress recognized this important contribution during the consideration of the Dodd-Frank reforms. Senate Agriculture Committee Chairwoman, Senator Blanche L. Lincoln (D-AR), in her July 15, 2010 Senate Floor speech,<sup>9</sup> during the consideration of the Dodd-Frank Conference Report, made it clear that the reforms were not intended to diminish the contributions to the agricultural contract markets made by investor trading entities such as Gresham, nor to restrain or substantially reduce their participation in such markets. In expressing that clear intent, Chairwoman Lincoln “recognize(d) that in setting these (position) limits, regulators must balance the needs of market participants, while at the same time ensuring that our markets remain liquid so as to afford end-users and producers of commodities the ability to hedge their commercial risk. Along these lines I do believe that there is a legitimate role to be played by market participants that are willing to enter into futures positions opposite a commercial end-user or producer. Through this process the markets gain additional liquidity and accurate price discovery can be found for end-users and producers of commodities.”

More recently, in a December 16, 2010 letter to Chairman Gensler, Chairwoman Lincoln stressed the importance of market liquidity provided by investors such as Gresham, in urging the Commission “to differentiate between trading activity that is unleveraged or fully collateralized, solely exchange-traded, fully transparent, clearinghouse guaranteed, and poses no systemic risk,” and that it not arbitrarily limit or negatively impact valuable market liquidity.

Specifically, Chairwoman Lincoln noted that:

“These investors often serve as an important, fully collateralized source of liquidity. At the same time, they are natural counterparties to producers who are seeking to reduce their commodity price risk. In this vein, as I have said previously, it is ‘my expectation that the CFTC will address the soundness of prudential investing by pension funds, index funds and other institutional investors in unleveraged indices of commodities that may also serve to provide agricultural and other commodity contracts with the necessary liquidity to assist in price discovery and hedging for the commercial users of such contracts.’”

“In addition to enhancing liquidity and facilitating greater price discovery for commercial end-users, diversified, unleveraged index funds are an effective way to diversify their portfolios and hedge against inflation. Unnecessary position limits placed on mutual fund investors could limit their investment options, potentially substantially reduce market liquidity, and impede price discovery. Such limits might also have the unintended consequence of forcing investors to rely on higher-cost managers with little experience, insufficient compliance and

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<sup>9</sup> Congressional Record-Senate, pages S5919-20, CREC-2010-07-15-pt1-PqS5902.pdf (pages S5919-20)

trade flow infrastructure, and limited risk management capabilities associated with effectively managing commodity index risk.”

The Proposed Rule does not differentiate between trading activity that is unleveraged or fully collateralized, solely exchange-traded, fully transparent, clearinghouse guaranteed, and which poses no systemic risk. Therefore, we urge the CFTC to do so in order to ensure the continued vibrancy of agricultural contract markets through the necessary liquidity provided by Gresham.

### **Bona Fide Hedge Exemption**

Gresham recommends that all existing hedge exemptions for non-commercial entities be immediately withdrawn and that only bona fide commercial interests that produce, process, manufacture, consume, utilize in some form, or finance or insure a commercial interest be accorded a hedge exemption. Failing this, Gresham submits that fairness should prevail and that the intent of its previous *No Action Letter* should be restored.

### **Position Visibility**

The Commission, based on its analysis of available data, proposes to allow a hedger to exceed the limits and then offset and re-establish the position, however, it would exclude agricultural commodities. Gresham endorses this proposal, which reflects the realities of the market place, but urges the Commission to treat the agricultural contracts no differently from the exempt commodities by including such contracts in the position visibility regulations for those who might exceed the speculative position limit.

### **Aggregation of Accounts**

The Commission carves out three exceptions in proposed Regulation 151.7 for account aggregation standards for limited partnerships (151.7(c)) in which the individual owns a 10 to 25 percent interest in the partnership and has no control or knowledge of the pool’s trading, for a Futures Commission Merchant (FCM) (151.7(e)) in discretionary accounts where the FCM has minimum control, and for independently controlled traders who are not a financial entity (151(f)).

Gresham falls between these three exceptions and, as stated above, it was the intent of the Congress as expressed by Chairwoman Lincoln “to differentiate between trading activity that is unleveraged or fully collateralized, solely exchange-traded, fully transparent, clearinghouse guaranteed, and poses no systemic risk,” and that it not arbitrarily limit or negatively impact valuable market liquidity.

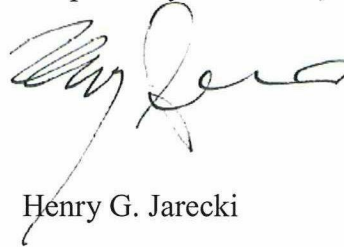
Therefore, Gresham, on its own behalf and that of its clients, seeks relief from the Commission for the unique investment services it renders in advising its clients in their investment decisions in the agricultural commodity futures markets. As stated at the outset of these comments, Gresham assists its clients in investing in commodities to allow them to reduce their risks in their overall portfolios and to help them hedge against

inflation by investing in long-only, unleveraged, tangible commodity futures portfolios either in accounts they hold with brokers or as participants in commodity pools we manage on their behalf. For the reasons that our investors are fully aware of what their investment choices will be and that he or she, not Gresham, decides when to enter or exit the market, and that we must adjust our position to accommodate our client's interest, an exception should be granted for investment entities who invest in and conduct themselves in the agricultural contract markets in a manner similar to that of Gresham.

For the reasons enumerated herein Gresham requests that the CFTC take the following action:

- Establish position limits on all agricultural contracts pursuant to the current open interest data utilizing and thus giving further substance to the Commission's well-chosen open interest formula that would set the limits at no more than 10 percent of the open interest of a contract market up to 25,000 contracts and 2.5 percent thereafter.
- Establish the new limits, as mandated by Dodd-Frank, no later than April 19, 2011.
- Recognize the positive and significant role of unleveraged investor trading entities, such as Gresham, in providing liquidity, price discovery, and convergence in the agricultural contracts, and not unreasonably restrain such market services by maintaining position limits that were established on the basis of 2004 open interest data.
- Determine that if existing hedge exemptions are not to be withdrawn, then, in the interest of a level playing field and fairness to Gresham and its clients, the *No Action Letter* issued to Gresham in 2006 be restored.

Respectfully submitted,



Henry G. Jarecki



**Exhibits**

**Open Interest Data  
 CFTC FORMULA 2010**

**Futures & Options Combined Open Interest**

	BO	C	CL	CT	HO	NG	S	SM	W	XB
January	269,833	1,435,139	2,585,721	235,030	360,648	924,807	572,952	199,811	492,798	295,500
February	324,979	1,385,976	2,517,994	239,186	355,917	943,720	547,226	224,551	492,782	301,144
March	325,054	1,520,751	2,572,830	276,886	379,445	956,495	574,632	228,728	532,156	351,127
April	309,239	1,490,534	2,779,554	272,750	380,678	961,518	609,276	221,547	528,700	349,555
May	360,102	1,595,631	2,764,954	270,662	365,283	970,255	592,187	195,487	575,689	283,594
June	335,813	1,458,113	2,590,346	219,190	391,396	885,962	550,065	212,042	518,643	263,177
July	327,045	1,591,725	2,540,817	229,545	385,561	873,598	584,787	215,673	596,686	292,721
August	313,603	1,822,805	2,656,537	318,896	415,259	920,071	659,521	234,433	578,381	273,077
September	396,789	2,096,043	2,649,955	398,257	429,026	867,006	812,023	239,829	616,141	275,522
October	447,561	2,431,281	2,720,853	442,630	435,049	882,561	824,864	244,638	660,009	312,236
November	398,807	2,043,404	2,389,568	333,790	374,644	838,078	907,072	227,793	525,597	296,240
December	429,409	2,220,581	2,464,805	361,915	384,412	826,937	927,497	232,577	596,899	307,387
<b>Average</b>	<b>353,186</b>	<b>1,757,665</b>	<b>2,602,828</b>	<b>299,895</b>	<b>388,110</b>	<b>904,251</b>	<b>680,175</b>	<b>223,092</b>	<b>559,540</b>	<b>300,107</b>

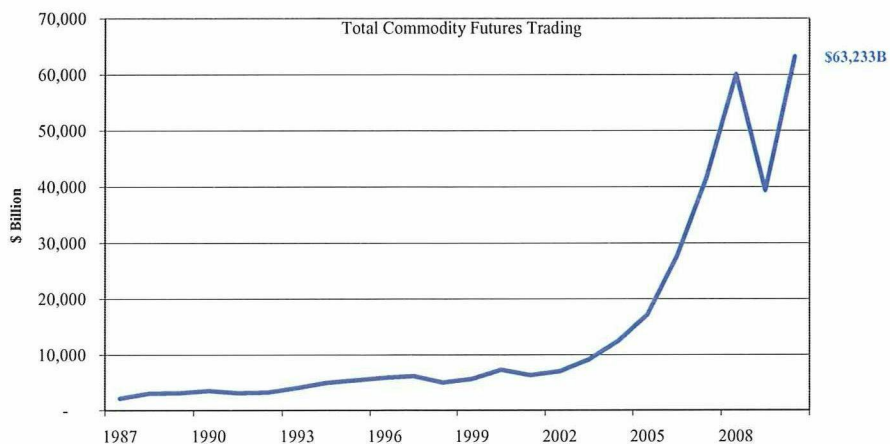
CFTC's position limit formula = 10% of first 25,000 and 2.5% of any OI above 25,000

	BO	C	CL	CT	HO	NG	S	SM	W	XB
January	8,621	37,753	66,518	7,751	10,891	24,995	16,199	6,870	14,195	9,263
February	9,999	36,524	64,825	7,855	10,773	25,468	15,556	7,489	14,195	9,404
March	10,001	39,894	66,196	8,797	11,361	25,787	16,241	7,593	15,179	10,653
April	9,606	39,138	71,364	8,694	11,392	25,913	17,107	7,414	15,093	10,614
May	10,878	41,766	70,999	8,642	11,007	26,131	16,680	6,762	16,267	8,965
June	10,270	38,328	66,634	7,355	11,660	24,024	15,627	7,176	14,841	8,454
July	10,051	41,668	65,395	7,614	11,514	23,715	16,495	7,267	16,792	9,193
August	9,715	47,445	68,288	9,847	12,256	24,877	18,363	7,736	16,335	8,702
September	11,795	54,276	68,124	11,831	12,601	23,550	22,176	7,871	17,279	8,763
October	13,064	62,657	69,896	12,941	12,751	23,939	22,497	7,991	18,375	9,681
November	11,845	52,960	61,614	10,220	11,241	22,827	24,552	7,570	15,015	9,281
December	12,610	57,390	63,495	10,923	11,485	22,548	25,062	7,689	16,797	9,560
<b>Average</b>	<b>10,705</b>	<b>45,817</b>	<b>66,946</b>	<b>9,372</b>	<b>11,578</b>	<b>24,481</b>	<b>18,879</b>	<b>7,452</b>	<b>15,864</b>	<b>9,378</b>

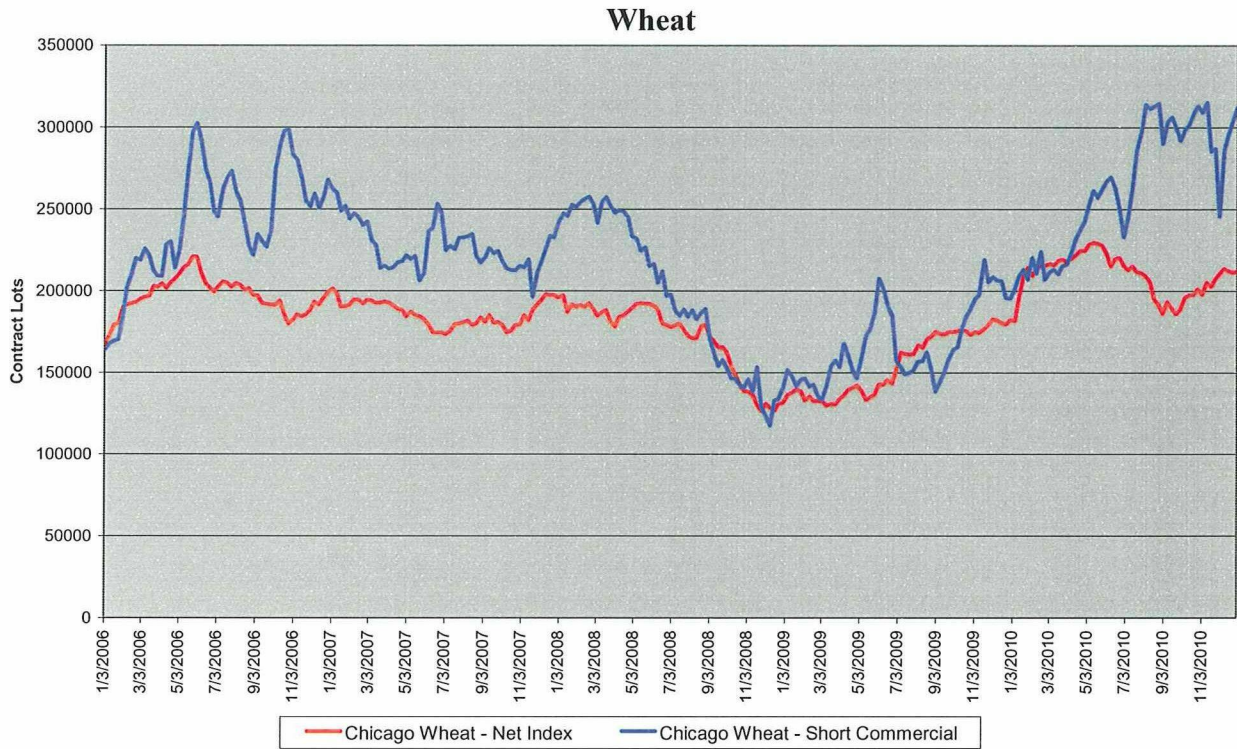
**Position Limits**

	BO	C	CL	CT	HO	NG	S	SM	W	XB
<b>Current All Month Limits</b>	<b>6,500</b>	<b>22,000</b>	<b>-</b>	<b>5,000</b>	<b>-</b>	<b>-</b>	<b>10,000</b>	<b>6,500</b>	<b>6,500</b>	<b>-</b>
<b>All Month Limits Based on 2010 Average Open Interest</b>	<b>10,705</b>	<b>45,817</b>	<b>66,946</b>	<b>9,372</b>	<b>11,578</b>	<b>24,481</b>	<b>18,879</b>	<b>7,452</b>	<b>15,864</b>	<b>9,378</b>

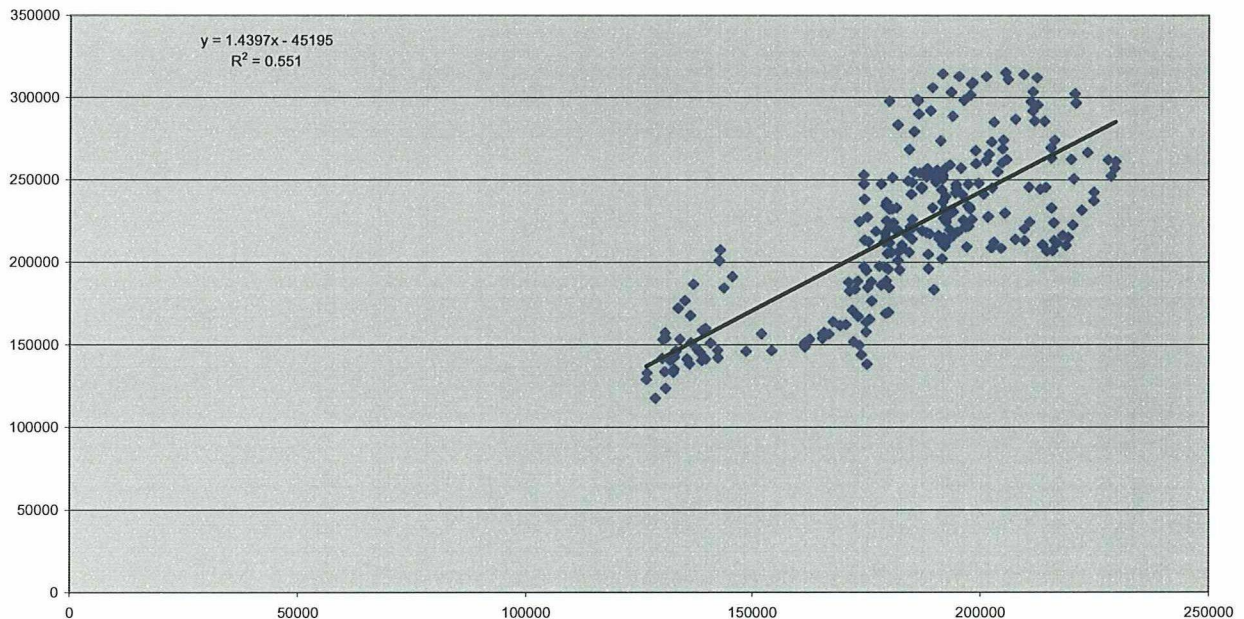
The chart above shows what the position limits would be according to the CFTC's proposed formula of 10% of the first 25,000 open interest and 2.5% thereafter using the average open interest in 2010. The higher limits reflect the significant increase in futures trading, as represented below by the growth in notional value of tangible commodity futures trading. BO = Soybean Oil, C = Corn, CL = Crude Oil, CT = Cotton, HO = Heating Oil, NG = Natural Gas, S = Soybeans, SM = Soybean Meal, W = Wheat, XB = Unleaded Gas.



### Net Index Positions versus Short Commercial Positions for Wheat, Corn, and Soybeans

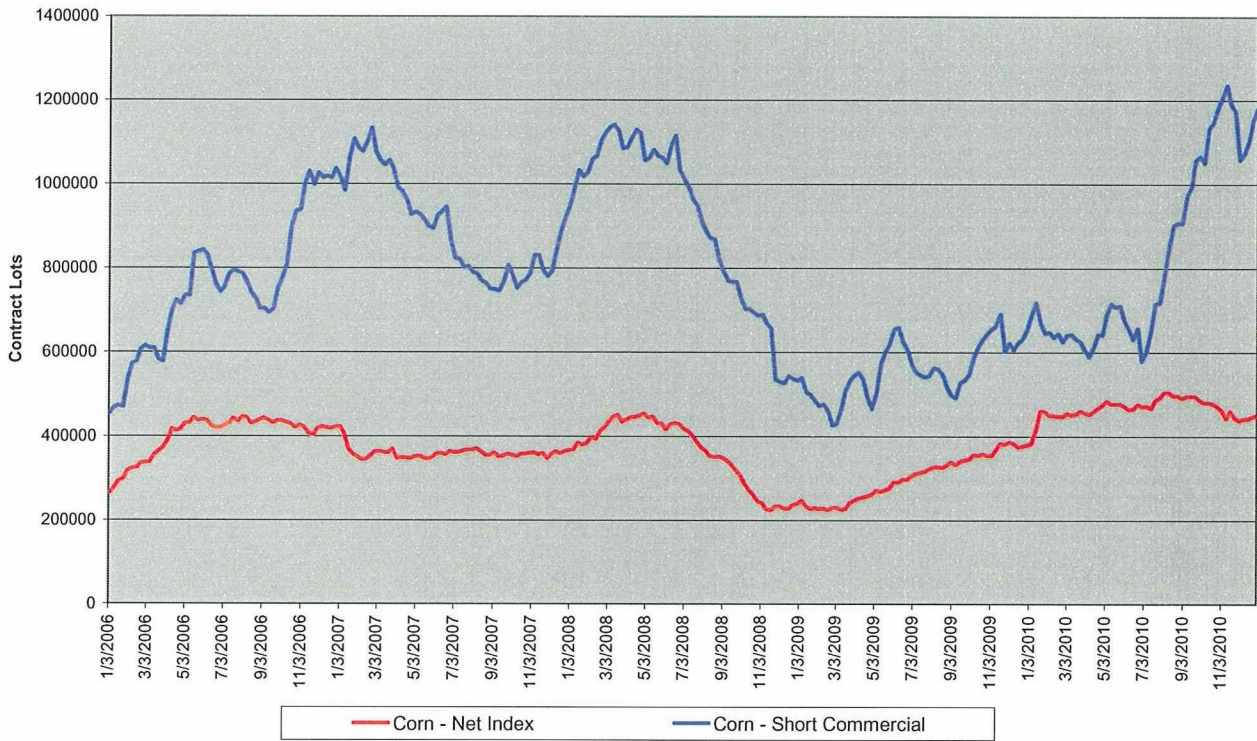


This chart shows that short commercial open interest in Chicago Wheat has increased more than net long index open interest in Wheat. In fact, for every Wheat lot that is held by an index, 1.4 Wheat lots are sold by commercials. This contradicts the assertion by NFGA, and others, that open interest figures are distorted by index speculators' domination of the Wheat and other Ag markets.

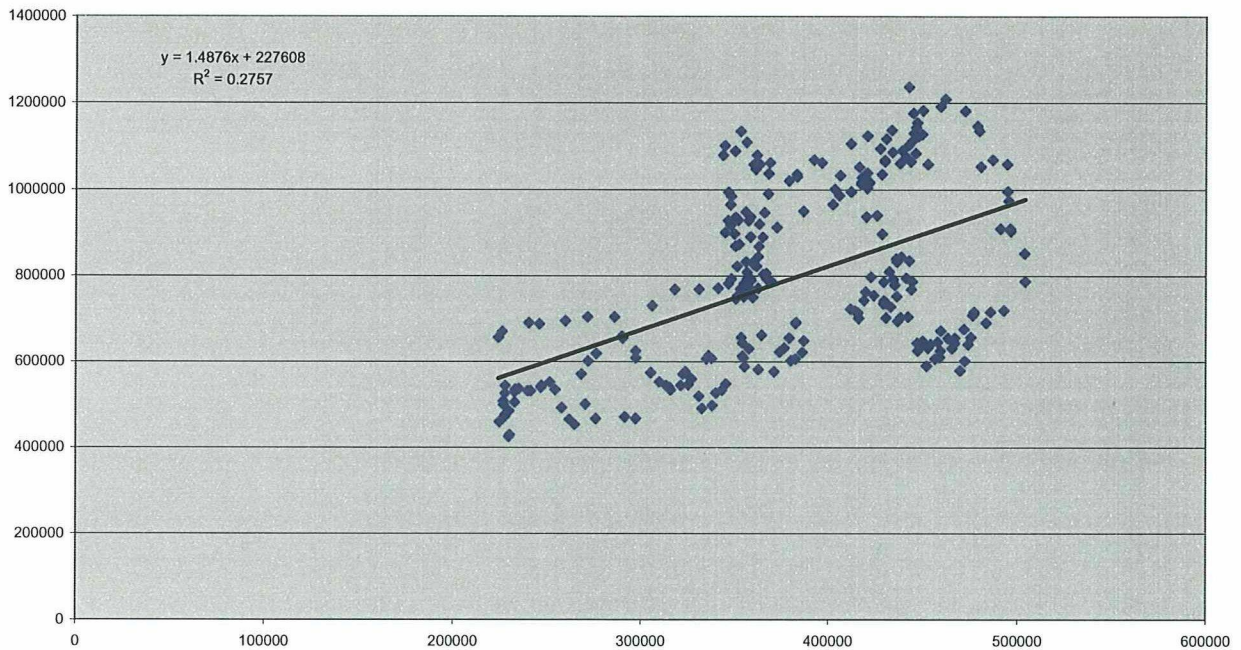


This slope of this scatter chart plotting short commercial open interest in Chicago Wheat versus net long index open interest in Wheat shows that for every Wheat lot that is held by an index, 1.4 Wheat lots are sold by commercials. The negative Y-Intercept indicates that there would not be any speculative longs available to commercial hedgers if index longs were to exit the market, although this is an extremely unlikely turn of events, it is obvious that the liquidity available to commercial hedgers would be significantly impaired.

**Corn**

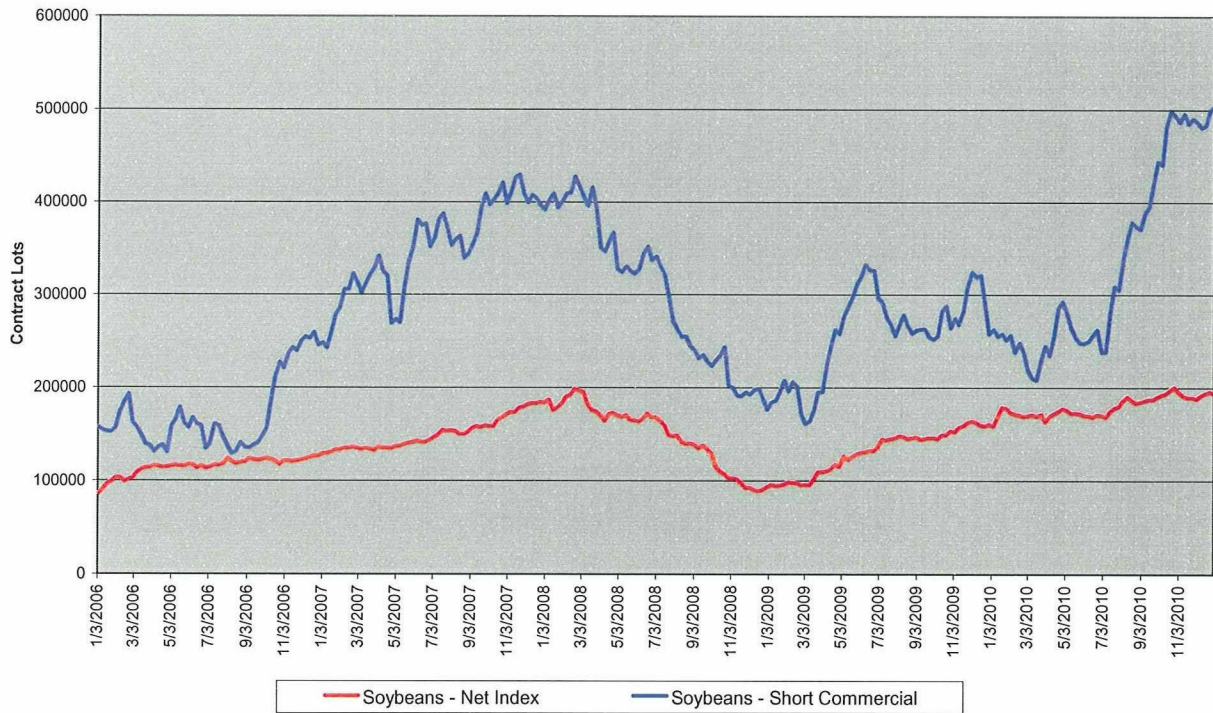


This chart shows that short commercial open interest in Corn has increased more than net long index open interest in Corn. In fact, for every Corn lot that is held by an index, 1.5 Corn lots are sold by commercials. This contradicts the assertion by NFGA, and others, that open interest figures are distorted by index speculators' domination of the Corn and other Ag markets.

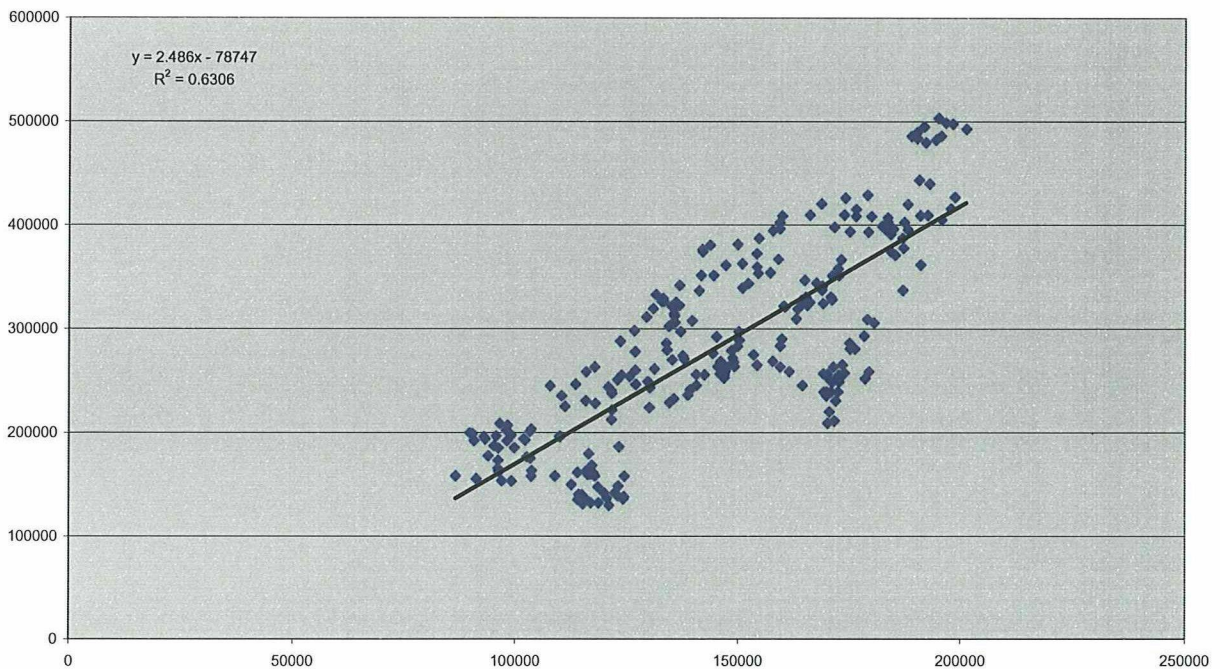


This slope of this scatter chart plotting short commercial open interest in Corn versus net long index open interest in Corn shows that for every Corn lot that is held by an index, 1.5 Corn lots are sold by commercials. The Y-Intercept indicates that there would still be speculative longs available to commercial hedgers if index longs were to exit the market.

### Soybeans



This chart shows that short commercial open interest in Soybeans has increased more than net long index open interest in Soybeans. In fact, for every Soybean lot that is held by an index, 2.5 lots are sold by commercials. This contradicts the assertion by NFGA, and others, that open interest figures are distorted by index speculators' domination of the Soybean and other Ag markets.



This slope of this scatter chart plotting short commercial open interest in Soybeans versus net long index open interest in Soybeans shows that for every Soybean lot that is held by an index, 2.5 Soybeans lots are sold by commercials. The negative Y-Intercept indicates that there would not be any speculative longs available to commercial hedgers if index longs were to exit the market, although this is an extremely unlikely turn of events, it is obvious that the liquidity available to commercial hedgers would be significantly impaired.