BARCLAYS CAPITAL

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March 28, 2011

Mr. David Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581
secretary@cftc.gov

RE: Position Limits for Derivatives (RIN 3038-AD15 and 3038-AD16)

Dear Mr. Stawick:

Barclays Capital[i] ("Barclays") is grateful to the Commission for the opportunity to comment on the changes that the Commission is proposing to make to the existing speculative limits regime. As a significant participant in the commodities markets, Barclays supports comprehensive and pragmatic regulation of these markets, and we understand that good things often come at a cost. However, we also think it is important that costs are incurred for the right reasons. We believe that the recent financial crisis showed the U.S. commodity futures markets to be one of the few "success stories" among the markets affected. The futures markets worked, the clearing systems worked, the risk management systems worked, and markets were orderly and sustained. While it is obviously important to fix systems that do not work, it is equally important to avoid creating new problems where there were none before.

Our comments are intended to offer practical insights drawn from our perspective as a market participant and, more importantly, as a risk manager to our clients. Barclays Capital's Commodities group operates a global risk management business utilizing the strongest balance sheet of any commodities trading bank. We have been active in the commodities markets for over 20 years and supported by a strong balance sheet, credit rating, and commodities risk management platform, we have over 300 front office commodities professionals who offer our 1,200+ clients a single point of service for all of their commodity related financing and risk management needs.

We are concerned that the proposal is vague in many instances and oversimplifies the legitimate complexity of risk management. While we understand that designing a workable regime necessitates some simplification of that which is inherently complex, we believe that any position limits regime must be flexible enough to deal with the reality that risk management in the commodity markets is not simple. Specifically, the underlying desire to tie every contract traded back to a physical molecule ignores that risks are managed as a portfolio. Risk in a portfolio is hedged on a net basis and for many reasons individual trades cannot be tied back to specific molecules. Many risks will offset each other, options will require delta-hedging, risks will be correlated between commodities, and inflation and other financial risks will be correlated with commodities. Because these net risks are not tied to a molecule does not mean that they are speculative.

We appreciate the efforts made by the Commission to address concerns raised before publication by Barclays Capital and other market participants. In particular, we applaud the Commission's decision to phase the rule's implementation and not to include the "crowding out" provision from its January 2010 proposed rules, which we believe would have had an extremely adverse impact on market liquidity with no material benefit to be gained. However, we remain concerned that the proposed rule still goes too far in several important respects, including:

- the independent account controller exemption from aggregation should remain available to all entities and should be available retroactively;
- the definition of *bona-fide* hedge, the deficiencies in the conditional exemption for financially-settled contracts and the "pass-through" hedge exemption concept as proposed and the need to facilitate effective and appropriate risk management; and
- the Commission must maintain flexibility and allow a grace period for certain unintended or unavoidable overages and limits on aggregate positions should not apply intra-day.

Many of these issues have been addressed in other comment letters, including those filed by the Futures Industry Association ("FIA") and International Swaps and Derivatives Association ("ISDA"), which Barclays Capital fully supports. We share the concerns of FIA and ISDA that the Commission has not provided evidence that excessive speculation exists, or that position limits would address problems created by excessive speculation. We also share Commissioner Dunn's concern that, "With such a lack of concrete 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."[ii] We believe that overmedication could lead to grievous side effects. This is a transformative moment for our industry in many ways and market participants (and markets) need time to adjust to the extraordinary changes being imposed on them. It is in this context that we urge the Commission to act judiciously and refrain from implementing any measures that are not either strictly required under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act") or that are required to address a clearly defined problem. Since the Commission will have access to significant additional data about the OTC markets in the coming months, at minimum, it should defer any decisions about the nature and extent of potential limits until after it has had a chance to assess the new data.

Similarly, we share the FIA's and ISDA's concerns about the unnecessary complexity of many aspects of the new regime, including the application and approval processes, the requirements for establishing exemptions and the many new reporting requirements. We support their recommendations to clarify and streamline the requirements and to reduce the administrative burden on market participants as much as possible. At a time when many of our existing processes are already changing and extraordinary and unprecedented new reporting requirements are being imposed across many parts of our organization, we believe that the Commission should seek to avoid imposing any burdens that are not absolutely necessary.

Note that, in consideration of the fact that the Commission has already received thousands of comment letters on this subject, we are restricting our comments to those that we consider to be additive to comments already on file or where our views diverge slightly from those expressed in the other comment letters.

There Should be Limits on Aggregation

We urge the Commission to reconsider and/or clarify the following points with respect to aggregation:

- **The independent account controller exemption should be retained for all entities**: We fail to understand why the Commission believes it is either necessary or appropriate to restrict the independent account controller exemption to non-financial entities. If an institution can demonstrate that it has no "control" over the positions in question (and, in many cases may even be prohibited from sharing specific information about the size or nature of the positions), then we struggle to understand the rationale for distinguishing a financial from a non-financial entity and denying the exemption to the former. Particularly at diverse financial institutions, there will be situations in which individual commodities traders are unaware of passive interests that the broader institution may have in other entities that also trade commodities (e.g., the institutions may have passive equity interests, step in or contingent ownership interests or hold ownership interests in the context of an underwriting). Although there is high level oversight, the information flow between the different parts of the institution is often specifically restricted, either because of public/private side restrictions or because of duties (possibly including fiduciary duties) owed to third parties, which puts the aggregation rules completely at odds with other rules and obligations that the entity is bound by. All of the financial institutions in question have other prudential regulators that control the nature and extent of such activities. If the Commission has concerns, then we urge them to defer to prudential regulators.

- **The self-executing exemption should be retained as a "safe harbor":** The kinds of passive interests described above are also examples of situations in which a trading group within an institution would not typically even be aware that a potential aggregation issue existed, let alone would it know enough to request disaggregation. If it failed to file the required application, it would then be required to observe a joint limit that the applicable information barriers make impossible to administer. Because of such situations, the Commission should either retain the self-executing exemption as a form of "safe harbor" or clarify that exemptions are not only effective when filed (as suggested by the FIA), but can apply retroactively.

- **The Commission should clarify that where there is neither ownership nor control, there is no aggregation**: Although it sounds illogical, some have suggested that the proposed rule might trigger aggregation in situations where

an entity neither has an ownership interest (direct or indirect) in the positions in question, nor exerts any control over the trading of such positions. The Commission should clarify that, in the absence of ownership, a "control" test similar to that used for disaggregation can be used to confirm that two entities are not subject to aggregation. Where there is any uncertainty as to whether or not aggregation has been triggered, the Commission could, upon request, examine the control factors and provide confirmation that aggregation has not been triggered.

- **The Commission needs to clarify what is meant by "ownership" / Ownership of an entity is not the same as ownership of an account**: In the past, the specific meaning of a phrase like "directly or indirectly has a 10 percent or greater ownership or equity interest" was not critical to the application of aggregation rules, since marginal situations were likely to be excused under the independent account controller exemption. In fact, determining the existence of an ownership interest was not even necessary in the absence of any indicia of control because the exemption was self-executing and the test would easily be satisfied in any case in which there were no indicia of control.

  However, if the Commission decides to fundamentally change the nature and extent of aggregation in the manner proposed, it will also need to be extremely clear about what constitutes ownership. Mere ownership of an entity is often not a useful proxy for control, particularly when the relevant concept is control of the trading of positions in an account in which the deemed "owner" may not have an interest. We are particularly concerned that the Commission may default to the kind of deemed "ownership" principles used in the securities industry, which would be a serious error. Among other things, these typically impute ownership in situations where there is no actual ownership and include contingent interests that are not in any way relevant to the Commission's efforts to prevent evasion of its speculative limits.

  The definition must be designed to fit the purpose. As a general matter, the aggregation rules should be as narrow as possible to address specific attempts to evade speculative limits. Accordingly, the only interest that should be relevant is a meaningful actual economic interest in the results of the trading of the positions in question. In most cases, we do not believe that ownership of 10% of the entity (vs the positions) would satisfy this test. We also do not believe that 10% is a meaningful proxy for control in a world in which it is no longer possible to prove the absence of control. While 10% might once have been a relevant touch-point that suggested the need to analyze the existence of control, we do not believe that 10% is a viable standard in the context of the proposed rule.

- **Aggregate only the pro-rata share of what is actually owned or controlled**: To the extent that aggregation is triggered and no exemption is available, the Commission should take this opportunity to clarify that only an entity's pro rata share of the positions that are actually controlled by it or in which it has an ownership interest will be aggregated. While we understand that it may be administratively easier for the Commission to monitor assuming 100% aggregation, we suggest that they consider positions in tiers (e.g., for ownership up to 20%, consider 20% and for ownership from 20-40%, consider 40%) and that the actual pro rata measure should always be the number used in assessing any potential "violation". The monitoring would still be imperfect, but the measures would still be more accurate than the 100% number attributed today. Moreover, this would avoid potential double (or more) counting of the same set of positions as there could be up to ten 10% holders, resulting in significant and irrational duplication. Such a proposal would obviously be subject to further public comment, but we believe that most market participants would find it to be fairer and more appropriate than the all-in rule that we have today.

The Importance of Risk Management

We believe that responsible and effective risk management should be encouraged, not prohibited. Accordingly, the definition of *bona fide* hedge should be as broad as possible within the confines of the Dodd-Frank Act to preserve and facilitate the kind of effective and appropriate risk management transactions that are being done today. As noted by the FIA and other commentators, this could include having a broader definition of *bona fide* hedge for swaps than for futures and options. Given that the Act was intended to minimize risk, it seems counter-intuitive to create a regime that makes it more difficult for market participants to appropriately manage and hedge legitimate market risk. The Commission should provide flexible means for market participants to hedge their risks and these should include the following:

- **The conditional exemption for financially-settled swaps is overly restrictive**: While we appreciate the Commission's recognition that physical and financially-settled contracts raise different considerations, we share the view expressed in other comment letters that the "exemption" for financially-settled contracts should be unconditional. Rather than denying a market participant the chance to select the best method of managing its risk, the Commission could simply cap the aggregate physical and financial position at the level of the conditional exemption. This would

avoid a potentially detrimental decrease in the liquidity of the physical contract and the consequential impact of such a decrease on the effectiveness of the price-discovery mechanism.

- **The "pass-through" exemption should be extended**: Although we greatly appreciate the Commission's efforts to allow a third party risk manager to manage another party's risk by creating what we will refer to as the "pass-through" exemption, we believe that this is one area where the Commission did not go far enough. We believe that the exemption should be available any time a third party risk manager manages another party's risk regardless of the nature of the risk. As long as the original holder of the risk was entitled to manage the risk under either a hedge exemption or could have done so within its speculative limits, the third-party risk manager should effectively be considered as stepping into the shoes of the original risk holder. It should not matter whether the original holder of the risk manages the risk itself or asks another to manage it for them and, indeed, overall systemic risk may be magnified if risk transfer is made more difficult. In a world in which the Commission will have access to information about the aggregate futures, options and swaps positions of all of relevant parties, there is no longer any need to fear abuse, particularly since the Commission retains the power to ask that any party bring down its positions if they pose a legitimate concern for the broader market.

- **The Commission should look to substance over form**: In assessing the applicability of the "pass-through" exemption, the Commission should ensure that it has the flexibility to consider the substance of a transaction rather than simply its form. Particularly in the context of complex financing transactions, entities will often enter into a series of transactions in which the purpose is to manage a single risk. However, the risk may flow through one or more entities before landing in the hands of the entity that will ultimately manage the risk. In such situations, it is appropriate for the Commission to look through the form of the transaction and allow the risk manager to avail itself of any pass-through exemptions that would have applied had it entered into the transaction directly with the original holder(s) of the risk.

The Need for "Safe Harbors" and Flexibility

In defining any new limits, the Commission should be mindful of the fact that market participants can only be expected to manage things that they can reasonably anticipate or that are under their control. In the context of limits, concerns arise in many different areas:

- The inclusion of the deemed "futures equivalent" of an options position and/or positions in related products may make it difficult to calculate the relevant number, particularly on a real-time basis. This could be further complicated by decisions about what constitutes (and how to handle) economically equivalent exposure.

- The nature of a position can change quickly and unexpectedly, such as where a "bona fide" hedge is effectively no longer a hedge due to the accidental loss of a cargo, force majeure or other interruption in the supply or delivery chain.

- Where aggregate limits are applied (either across products or between Futures and OTC), there may be timing mismatches that render the information inaccurate on a real-time basis. For example, there will always be a gap between the entry into an OTC trade with an end-user client and the entry of the related hedge in the futures markets. This timing gap could be significant for larger risk management programs as the risks may need to managed (and hedges refined) over a longer period of time.

- To the extent that the positions of different entities are aggregated, but are not actively controlled by a common account controller, there may be impediments (or outright bars) to sharing of the relevant information. In extreme cases, such as the public/private issues cited above, one trader may not even be aware, or may not be permitted to be aware, of the existence of the positions, let alone be able to manage the aggregate position.

- Even where all of the relevant information is technically available, it may extraordinarily difficult to capture and collate it on a real-time basis, making effective monitoring next to impossible. For example, there may be multiple SEFs and exchanges trading related products that may also trade OTC and each of these inputs may be received at a different time, giving an inaccurate picture of the aggregate risk to anyone trying to monitor on an entity-wide level. Or there may be multiple traders using a variety of front-end systems trading in many different jurisdictions and the information will be difficult to capture on a consistent basis. The timing issues are even more complex where executing brokers or counterparties enter trades and they are given up or allocated after the initial execution.

- In certain special circumstances, large portfolios may need to change hands relatively quickly to allow risks to be managed in a safe and effective manner and this may be extremely difficult to manage within the confines of the proposed limits regime, particularly when the portfolio is integrated into an existing portfolio and particularly if the rules apply to the newly combined portfolio on a real-time basis.

We believe that it would be fundamentally unfair to hold market participants to a standard that they cannot reasonably achieve and we urge the Commission to take this opportunity to clarify that temporary relief may be available in certain circumstances, including:

- **A grace period should be allowed to cure certain "excusable" overages:** Where an overage is triggered by events that the market participant could not reasonably control or anticipate, such as the loss of a cargo or a dramatic swing in price that changes the futures equivalent of an options position, we believe that there should be a grace period to allow the market participant time to bring the position into compliance with the limits. In most cases, if the issue is identified at the end of a day, the position can be adjusted during the following trading day, although there may be exceptional circumstances that could warrant a longer grace period (e.g., natural disasters, pandemics, terrorist attacks or extreme market events). Less liquid markets will also require special accommodations as delta-hedging can take much longer in these markets. We suggest that a one-day grace period could be implemented, with the Commission retaining flexibility to grant a special circumstances exemption as appropriate.

- **Aggregate Limits should not apply on an Intraday basis**: Given the complexity of administering any aggregate limits, the challenge (and in some cases impossibility) of sharing and collating information on a real-time basis and the inherent timing disconnects that may exist, we do not believe that it is appropriate for the Commission to apply aggregate limits on an intra-day basis. We view this as another form of "excusable" overage that should qualify for a grace period, the length of which can be determined based factors such as market liquidity.

- **Special Circumstances require Special Considerations**: Over the past few years, the commodities markets have seen several situations in which large portfolios are required to be transferred from one market participant to another to facilitate efficient risk management of the positions. This can occur in a wide variety of situations, including where an entity is restructuring or exiting a line of business, in the context of a potential bankruptcy or in the event of a customer default at an FCM. Such transactions are typically done in close cooperation with the relevant exchanges or clearinghouses in the context of permitted "ex-pit" transfers. Once transferred, it may be difficult to manage the risks immediately without disrupting the relevant markets. Particularly given the socially useful role played by the risk manager in helping to stabilize these situations, we believe it is critical for the Commission to be give itself the flexibility to accommodate these and other special circumstances that it determines warrant either a temporary exemption or other special relief.

Conclusion

Although we understand that the Dodd Frank Act requires the Commission to consider new position limits rules, and that it is under pressure to respond to the perception that "speculation" is responsible for rising commodity prices, we urge it to be cautious as we fear that the proposed rules may have unintended consequences with undesirable impacts on the price discovery process. We believe that the changes we and others have proposed will mitigate this risk. We also believe that the issues we raise identify areas in which the proposal may be inconsistent with the desire to create a coherent policy that does not impose undue burdens on market participants.

Larger swap dealers and commercial participants with trading and marketing operations serve a valuable purpose by using their capital, experience, and diversified platforms to structure unique risk management and financing solutions for important infrastructure projects and their corporate sponsors. A market in which these intermediaries of scale are unable to continue to provide risk management for large and/or complex customer exposures will ultimately increase costs for these types of projects and reduce overall capital investment in these sectors. This could lead to serious unintended consequences, ultimately impacting energy prices. The commodities markets today are more liquid, longer term, and lower cost than they were even 10 years ago. This has provided a service to the American public by facilitating greater investment in energy infrastructure and lower cost risk management. It would be a shame to eliminate these realized benefits for present and future generations and consumers of energy.

Barclays Capital believes that the important objective of appropriate regulation can be achieved without jeopardizing the robust, liquid markets that facilitate effective hedging for Corporate America's *legitimate* risk management needs and we appreciate the opportunity to participate in this important dialogue. Please do not hesitate to contact us if you would like us to elaborate on any of our suggestions or provide any data which may be required to thoroughly evaluate the implications of this proposal.

Sincerely,

Roger Jones
Managing Director, Global Head of Commodities
Barclays Capital

cc: Honorable Gary Gensler, Chairman
Honorable Michael Dunn, Commissioner
Honorable Jill E. Sommers, Commissioner
Honorable Bart Chilton, Commissioner
Honorable Scott O'Malia, Commissioner
Daniel Berkovitz, General Counsel
Terry Arbit, Deputy General Counsel, Office of the General Counsel
Stephen Sherrod, Acting Director of Surveillance
Bruce Fekrat, Special Counsel

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[i] Barclays Capital is the investment banking division of Barclays Bank PLC. Barclays Capital provides large corporate, government and institutional clients with a comprehensive set of solutions to their strategic advisory, financing and risk management needs. Barclays Capital has offices around the world and employs over 25,000 people.

[ii] Commissioner Michael V. Dunn, Opening Statement, Public Meeting on Proposed Rules Under Dodd-Frank Act, January 13, 2009. http://www.cftc.gov/PressRoom/SpeechesTestimony/dunnstatement011311.html.