P I M C O

Via Electronic Submission

March 28, 2011

Mr. David A. Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Proposed Federal Speculative Position Limits for Referenced Contracts

Dear Mr. Stawick:

This letter is submitted on behalf of the Pacific Investment Management Company LLC ("PIMCO") in response to the proposed rules issued by the Commodity Futures Trading Commission (the "CFTC" or the "Commission") regarding the imposition of speculative position limits on futures and options contracts in 28 exempt and agricultural commodities (the "Proposed Rules")[1] and their economically equivalent swaps, pursuant to Section 737 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank").[2] The Proposed Rules also contain provisions that address the aggregation of positions under common ownership for the purpose of applying the limits, as well as provisions that would exempt certain bona fide hedging transactions from the position limits.

Thank you for this opportunity to share our comments with the Commission, building on the comments we submitted in response to the Concept Release issued by the Commission in 2009[3] and to the January 26, 2010 Proposed Rule regarding whether the CFTC should directly impose speculative position limits on futures and options contracts in four energy commodities.[4]

---

[1] Position Limits for Derivatives, 76 Fed. Reg. 4752 (Jan. 26, 2011) (to be codified at 7 C.F.R. pts. 1, 150, and 151).

[2] H.R. 4173 (111th Cong. 2d Sess. 2010).

[3] PIMCO Comment Letter to the CFTC, re: Concept Release on Whether to Eliminate the Bona Fide Hedge Exemption for Certain Swap Dealers and Create a New Limited Risk Management Exemption from Speculative Limits, dated May 28, 2009.

[4] PIMCO Comment Letter to the CFTC, re: Proposed Federal Speculative Position Limits for Referenced Energy Contracts and Associated Regulations, dated April 23, 2010.

Background
PIMCO manages the investments of millions of individuals and thousands of different institutions in this country, including state retirement plans, unions, university endowments, corporate defined benefit plans and pension plans for teachers, firefighters, and other government employees. Our services are provided through the management of separate client accounts, in accordance with the specific investment styles and objectives specified by the client, and through the management of mutual funds that are offered to institutional and individual investors. In the case of all of these management services, we are solely engaged in the long-term investment management of our clients' assets, in the full legal duties of a fiduciary. We do not engage in proprietary trading for our own account nor directly hold client funds, nor provide balance sheet lending to our investment clients. Our principal goal is to make sound, long-term investments that will meet our clients' objectives and provide them with stable and acceptable returns that are consistent with their risk preferences over their desired time horizons. In this context, our passive commodity index mutual funds allow investors to invest in a diversified basket of commodities, without affecting or intending to affect or disrupt any particular market or commodity. For instance, our flagship commodity mutual fund provides inflation protection and portfolio diversification for over 750,000 American investors.

PIMCO is registered as a commodity pool operator with the CFTC and an investment adviser with the Securities and Exchange Commission (the "SEC"), and with respect to funds managed by PIMCO that are registered under the Investment Company Act of 1940 (the "1940 Act"), the assets that PIMCO invests are not leveraged or uncovered.

We strongly believe that efficient, competitive, and liquid futures and swaps markets are essential to our business and the businesses of many other market participants. We are very interested in ensuring that all markets have sufficient liquidity and capacity to meet the needs of our clients. Thus, we support the efforts of the Commission to ensure the price discovery function of the commodity derivatives markets is sufficient to accommodate all market participants.

We believe that diversified commodity index investors have much more in common with commercial hedgers than with speculators. Diversified commodity index investors establish net-long positions in the commodity derivatives markets to hedge the inflation risk and financial risk that exists elsewhere in their portfolios. They are not taking "directional bets" on individual commodities. As a result, PIMCO, on behalf of its clients, uses the futures and swaps markets for risk mitigation, just as traditional commercial participants use the markets to hedge business risk. While some larger institutions, such as pension funds and endowments, directly make these index investments to hedge their financial risk and inflation risk, PIMCO in addition manages an important financial and savings vehicle for a broad swath of Americans by providing hundreds of thousands of individual investors with the ability to efficiently mitigate these same risks through our commodity-indexed mutual funds.

Introduction
Under Phase One of the proposed position limit regime, the Commission would set an initial spot-month position limit on futures and swaps on the 28 referenced contracts, based on limits currently imposed by designated contract markets ("DCM") and exempt commercial markets. To be clear, PIMCO's commodity strategies do not hold any positions during the spot month. Given the greater volatility around the expiration of these contracts and the fact that this is where futures converge to cash prices, we believe it is appropriate for the Commission to focus its efforts on the spot month. However, we do believe that certain provisions related to the Phase One limits should be modified to prevent unnecessary disruptions to the commodity markets, as explained below. Furthermore, we do not believe that the Commission should move forward with Phase Two of the Proposed Rules, which would impose single-month and all-months-combined position limits on futures and swaps, as well as an aggregate limit across both futures and swaps, on the 28 referenced contracts. At a minimum, the Commission should postpone the detailed description and implementation of Phase Two until a later date only and if it can establish a clear, definitive and reliable record to support the required conclusion that position limits will address problems related to excessive speculation and market manipulation in commodity markets, and even then only when the Commission can further determine that such limits will not impair the liquidity or price discovery function of the commodity markets. If the Commission does move forward with Phase Two of the Proposed Rules, we strongly believe that the Commission should take a tailored, "surgical" approach to imposing position limits.

We request that the Commission confirm that the 28 referenced contracts do not include commodity index contracts that may include some or all of the 28 referenced contracts. The explanatory notes prepared by the Commission on setting non-spot-month position limits state, "As proposed, the definition of a referenced contract explicitly excludes all basis and commodity index contracts, as those terms are defined in proposed regulation 151.1." Under §151.1 of the Proposed Rule, a commodity index contract is "an agreement, contract or transaction that is not a basis or spread contract, based on an index comprised of prices of commodities that are not the same nor substantially the same, provided that, a commodity index contract that incorporates the price of a commodity underlying a referenced contract's commodity which is used to circumvent speculative position limits shall be considered to be a referenced contract for the purpose of applying the position limits of § 151.4." As discussed above, PIMCO uses commodity index contracts to allow individual investors to invest in a diversified basket of commodities as both a diversifying tool and an inflation hedge. While we believe the explanatory notes and the Proposed Rules are clear on this issue, we believe this provision has been misunderstood by relevant policymakers and must be further clarified. However, even with such clarification, PIMCO is very concerned that other elements of the Proposed Rules, including those elements that restrict the activities of swap dealer intermediaries will have a serious adverse effect on PIMCO's ability to conduct its business and serve its clients.

CFTC Should Modify Phase One
Although PIMCO does not hold positions in the spot month, we are concerned that certain provisions in the Proposed Rules related to Phase One will be harmful to the commodity markets. Therefore, we urge the Commission to eliminate the restrictions on the ability of a market participant to utilize the position limits of their counterparties and to modify the aggregation requirements.

Pass-Through of Position Limits to Swap Dealers
The Proposed Rules restrict the ability of a counterparty to utilize the position limits that their over-the-counter counterparties might have available to them, except for bona fide hedging transactions. As a result, even if a counterparty enters into a transaction with a market participant that leaves the market participant below the speculative position limit, the counterparty may not rely on the position limits available to the market participant when offsetting the risk of the transaction. In our view, such a restriction on "pass through" is in no way required by Dodd-Frank and will be harmful to PIMCO's investors. To the contrary, we believe that allowing financial intermediaries to rely on their counterparties' position limits is warranted, because the intermediation function that these market participants, such as swap dealers, perform is hedging of their commitments – and does not increase the level of activity in the markets: it merely transfers net risk from one execution venue to another. Given the Commission's expanded authority under Dodd-Frank to address all swap transactions including OTC swaps, we believe there is no ability for a counterparty to evade the position limits through a transaction with another market participant, as the Commission now has authority to impose limits on all swap positions. While we acknowledge the Commission's efforts to allow this pass-through in the context of a counterparties' bona fide hedging, we believe it should be extended to all trading activity since from the intermediary's perspective, it is engaged in traditional hedging activity. If any market participant remains under its position limit, a counterparty dealer should be permitted to carry the position limit (*e.g*., to permit futures or swaps trading) of that counterparty, up to the position limit (whether traditional hedging or investing) that is applied to such counterparty.

Aggregation of Accounts
The Proposed Rules will require aggregation for any positions in which any trader has a 10% or greater equity interest. Exemptions from the aggregation requirement will be available for positions held by "pools," futures commission merchants, and for positions of independently controlled and managed traders that are not financial entities. Exemptions will be available only upon application to and approval from the CFTC. We believe that the Commission should modify these provisions to ensure that they do not unnecessarily restrict liquidity in the markets for the referenced contracts and impair the price discovery function of these markets.

In setting position limits, we believe that the CFTC should not aggregate the positions of the various accounts managed by PIMCO, as they each have "different and systematically determined investment objectives." Commodity index funds and separate accounts managed by PIMCO have their own investment guidelines, with different

benchmarks, risk and return objectives and collateral obligations. PIMCO services its investors through the management of separate client accounts, in accordance with the specific investment styles and objectives specified by the client, and through the management of mutual funds that are offered to institutional and individual investors, which are managed specifically to the objectives, guidelines and benchmarks unique to those funds. In the case of all of these management services, PIMCO is solely engaged in the investment and trading of our clients' assets, in the role of a fiduciary, and does not engage in proprietary trading for its own benefit. Then Senate Agriculture, Nutrition, and Forestry Committee Chairman Lincoln stated that she "would encourage the CFTC to consider whether it is appropriate to aggregate the positions of entities advised by the same advisor where such entities have different and systematically determined investment objectives."[5]

Furthermore, the aggregation provisions will require swap dealers to aggregate their holdings across business units, and because of position limit restrictions on the referenced commodities will potentially have to ration their services. PIMCO has a strong and unambiguous interest in preserving a swap dealer market that is competitive, well-capitalized, and with robust risk management. Therefore, dealers should be able to net their positions across platforms (OTC swaps plus futures) in assessing their compliance with positions limits. Otherwise, this would reduce the ability of investment managers such as PIMCO to hold long-term and growing positions with capable swap dealers. PIMCO and its clients would have to rely on less creditworthy and less skilled swap dealers, which would reduce liquidity in the markets, and will raise costs for all investors and commercial producers. The effect of these position limits is to force artificial size limitations on commodity index funds. This would limit the ability of individual investors to manage their growing financial risk and inflation risk over time, while reducing the liquidity in the futures market for commercial producers that is currently provided by larger commodity index funds.

Finally, as we noted in our April 2010 Comment Letter, we believe that the CFTC should apply the independent account controller exemption to both financial and non-financial entities that comply with the informational barriers under the Proposed Rules. Common ownership does not per se mean common control. The CFTC's rationale for limiting the exemption to non-financial entities is flawed, as we do not believe that the position limits are high enough to offset the elimination of this exemption, which has long been relied upon by market participants and will drive larger market participants out of the commodity markets. Furthermore, we note that many financial market participants have implemented robust informational barriers between separate legal entities that trade in these markets. The elimination of the independent account controller exemption will restrict the size of the positions that may be held by financial entities in the markets, including financial intermediaries, and will significantly reduce market liquidity, while raising the cost of risk management for all market participants, including non-financial entities.

[5] 156 Cong. Rec. S5920, July 15, 2010.

CFTC Has Not Demonstrated Need for Phase Two Position Limits
As an initial matter, the release accompanying the Proposed Rules (the "Release") failed to demonstrate any need for Phase Two limits. Numerous studies have failed to identify a defined connection between excessive speculation in the non-spot month and commodity price increases. Furthermore, several of these studies specifically focused on the role of commodity index funds, and reached the same conclusions. For example, a January 2009 memo prepared by the Government Accountability Office found, using "statistical techniques… designed to detect very weak or even spurious causal relationships," and based upon both public and non-public data, "limited evidence" that speculation causes changes in commodity prices "regardless of whether the studies focused on… index traders, specifically, or speculators, generally."[6] The CFTC itself has not yet identified a link between commodity index investors and rising commodity prices.[7] In addition, we have not seen any evidence that trading by speculators in the non-spot months has disrupted the markets for the 28 referenced contracts, particularly for non-spot contracts. We encourage the Commission to continue to focus on manipulation and market disruption around contract settlement.

As Commissioner Dunn noted during the CFTC's January 2011 open meeting to adopt the Proposed Rules (the "January Meeting"), the CFTC needs more than anecdotal evidence on the impact of excessive speculation on commodity markets or that position limits will reduce excessive speculation, to impose position limits. He then stated that "[t]o date, CFTC staff has been unable to find any reliable economic analysis to support either the contention that excessive speculation is affecting the markets [the CFTC] regulate[s] or that position limits will prevent excessive speculation." Finally, "[w]ith 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." We strongly agree with the statements made by Commissioner Dunn and urge the Commission to consider whether it should impose Phase Two position limits.

While PIMCO supports the CFTC's efforts to ensure that commodity markets are fair and orderly and facilitate the trading activity and risk management functions of all market participants, we believe that the imposition of position limits "prophylactically"[8] is neither mandated by Dodd-Frank nor a permitted basis to impose position limits as a matter of law. New Section 4a(a)(1) of the Commodity Exchange Act ("CEA") provides the Commission authority to impose position limits that "are necessary to diminish, eliminate, or prevent" the burden of excessive speculation. New Section 4a(a)(3) of the

---

[6] Issues Involving the Use of the Futures Markets to Invest in Commodity Indexes, Government Accountability Office, at 5 GAO-09-285R Commodity Indexes (January 30, 2009).

[7] A draft report by an interagency task force led by CFTC staff in 2009, obtained by The Wall Street Journal through the Freedom of Information Act, around January 2009, stated "there is not enough evidence to support the argument that the commodity index funds cause price spikes in commodities." Sarah N. Lynch, CFTC Documents Reveal Internal Debate on Position Limits, Wall St. J. Online, May 14, 2010.

[8] 76 Fed. Reg. at 4754.

CEA qualifies the CFTC's authority by directing it to set position limits, "as appropriate. . . [and] to the maximum extent practicable, in its discretion: (i) to diminish, eliminate, or prevent excessive speculation . . ; (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." Congress, by directing the CFTC to consider not only excessive speculation and market manipulation, but also market liquidity and price discovery, intended to strike a balance between these competing aims. However, the Proposed Rules have failed to do so, as the Commission has not made a factual determination that position limits are "necessary" and "appropriate," as it is required to do under Dodd-Frank.

As a practical matter, the CFTC does not have any meaningful data on the size of the commodity swap market, and it would be premature to impose a position limit regime without fully understanding these markets. Commissioner Sommers noted at the January Meeting that the CFTC does not have the appropriate data to impose position limits and therefore the Proposed Rules are "flawed in a number of respects [and the CFTC] should conduct a complete analysis of the swap market data before [it] determine[s] the appropriate formula to propose." We agree with Commissioner Sommers. The Commission's authority to impose limits on economically equivalent swaps in Section 4a(a)(5) is premised on providing consistent treatment between swaps and future or option contracts, and we do not believe that the Commission can do so without having a complete understanding of the swaps market, and in particular, its size.[9]

Lack of Cost-Benefit Analysis

As Commissioner Sommers noted, the Commission has consistently failed to conduct a "thorough and meaningful" cost-benefit analysis on the Proposed Rules or any other rulemakings promulgated by the CFTC under Dodd-Frank. Commissioner Sommers' concern was reiterated in a letter dated February 15, 2011, sent to Chairmen Gensler, among others, and signed by ten members of the Senate Banking Committee. The letter stressed "the importance of rigorous cost-benefit and economic impact analysis," and asked various federal agencies to explain the steps they are taking to ensure that the rules adopted pursuant to Dodd-Frank "are the least burdensome way to achieve the statutory mandate[s]" and "to ensure that all empirical data and economic analyses… are thoroughly considered before a final rule is adopted." Given the loss of liquidity and increase in prices in commodity markets and the significant financial and regulatory burdens the Proposed Rules will impose on market participants, the failure to conduct cost benefit analyses suggests that the Commission cannot provide any economic justification for the Proposed Rules. While we understand that Section 15(a) of the CEA does not require the Commission to quantify the cost of the Proposed Rules, we are deeply troubled that the Commission has failed to consider the costs of the Proposed

[9] *See* 76 Fed. Reg. at 4755 ("Because it has the authority to gather data and impose regulations across trading venues, the Commission is uniquely situated to establish uniform position limits and related requirements for all economically equivalent derivatives. A uniform approach would also encourage better risk management and could reduce systemic risk.").

Rules on market participants in any meaningful way. However, we are pleased that Chairman Gensler agreed at the Senate Agriculture Hearing earlier this month that the Commission will provide a "meaningful" cost-benefit analysis prior to issuing any final rule, including the Proposed Rules.

Movement of Markets Abroad

We note that Section 737 of Dodd-Frank requires the CFTC to "strive to ensure that trading on foreign boards of trade in the same commodity will be subject to comparable limits and that any limits to be imposed by the Commission will not cause price discovery in the commodity to shift to trading on the foreign boards of trade." As Commissioner Sommers noted at the January Meeting, "[t]his proposal does not contain any analysis of how the proposal attempts to accomplish this goal. In fact, the proposal does not even mention this goal. Driving business overseas is a long standing concern of mine, and that concern remains unaddressed." We agree, and we believe that without more study and coordination with foreign regulators, position limits could have the unintended consequence of decreasing domestic competitiveness and shifting these commodity markets overseas.

Commissioner Dunn also noted at the January Meeting that if the CFTC determines that position limits are appropriate, "[it] must then work with [its] sister regulators around the globe to ensure that limits set here in U.S. markets, are not simply evaded by trading in other venues around the world." This sentiment is shared by ten members of the Senate Banking Committee in a February 8th letter that stated "[an] overly prescriptive derivatives market in the U.S. would no doubt encourage market participants to take advantage of less punitive derivatives marketplaces abroad." Likewise, in a recent letter to U.S. financial regulators, including Chairman Gensler, House Financial Services Chairman Bachus and House Agriculture Chairman Lucas noted their concern that "foreign markets are closely examining how U.S. regulators are implementing Dodd-Frank and stand ready to create a competing non-punitive derivatives marketplace." We share the concerns expressed above and believe that the imposition of position limits in U.S. markets regulated by the CFTC without comparable position limits on foreign markets would have the effect of driving trading to unregulated markets or foreign exchanges, which would increase price volatility and hamper price formation in U.S. commodity markets. Therefore, we believe that adoption of a permanent position limit regime should be postponed until the Commission has fully consulted with its counterparts around the globe about harmonizing limits and phasing them in simultaneously, so as to ensure that position limits imposed on U.S. markets do not shift business offshore.

Exemptions

We believe that the Commission should revise the process by which it proposes to grant exemptions from the position limits. A wide variety of market participants have relied on exemptions from position limits for over twenty years, and the exemptions provided by the Commission to market participants have evolved over time to address the hedging strategies implemented to mitigate an expansive range of commercial risks. We are

concerned that a narrow interpretation of the exemptions under Dodd-Frank by the Commission will greatly restrict normal hedging activity, limiting the ability of market participants to manage and reduce their financial risks.

New Section 4a(a)(1) of the CEA gives the Commission authority to set aggregate position limits by "group or class of traders," and new Section 4a(a)(7) of the CEA gives the Commission authority to provide exemptions from these position limits to any "person or class of persons." However, the Proposed Rules do not consider the application of different position limits or exemptions from the position limits for different types of market participants, and we strongly urge the Commission to exercise this broadened exemptive authority. At the January Meeting, Commissioner Sommers noted that neither the Release nor the Proposed Rules "analyze, or in any way consider, whether different limits are appropriate for different groups or classes of traders."[10] We concur and we encourage the Commission to explore whether it would be more appropriate to treat categories of market participants differently, based on their respective uses of commodity derivatives, their role in the commodity markets and other factors.

We believe that treating different classes or groups of traders differently would be consistent with congressional intent. For example, Chairman Lincoln, noted in a letter to Chairman Gensler that she was "mindful of the CFTC's discretion to set aggregate position limits by 'group or class of traders.'"[11] However, at a hearing on February 15, 2011, before the House Financial Services Committee on Title VII, Chairman Gensler stated that the position limit proposal does not make a distinction between speculators and index fund investors because Dodd-Frank does not make that distinction. We disagree and we believe that members of the committee, notably, Rep. Brad Sherman disagree, as well. While we are pleased that Chairman Gensler agreed to "keep an open mind" on this issue, we believe that Dodd-Frank is clear on this matter, and we strongly urge the Commission to use its discretion to implement position limits that reflect the positive role played by commodity index investors in the commodity markets.

As discussed above, commodity index funds serve a very important role in the commodity markets and for institutional and individual investors. Furthermore, unlike other large market participants, commodity index funds are subject to extensive regulation by the SEC, as registered investment companies pursuant to the 1940 Act. The SEC has the authority to examine the trading records, including accounting records, shareholder records, communication records, transaction records and trade reports of registered investment companies. In addition to the regulation of investment companies under the 1940 Act, these companies are advised by SEC registered investment advisers. The 1940 Act limits the extent to which these funds can employ leverage, which further restricts their impact on the futures and commodity derivatives markets. Commodity

---

[10] Opening Statement by Commissioner Jill Sommers, Open Meeting on Ninth Series of Proposed Rules under the Dodd-Frank Act, January 13, 2011.

[11] Letter from Senator Blanche Lincoln, Chairman of the Senate Committee on Agriculture, Nutrition, and Forestry to CFTC Chairman Gary Gensler, Re: CFTC's Implementation of Position Limits, dated December 16, 2010.

index funds are required to hold segregated liquid assets to cover all of their positions. As such, they pose little or no systemic risk to the market and their unlevered nature allows them to provide stability to the markets as well. We note that during the liquidity crisis of the last half of 2008, the commodity futures markets continued to operate in an orderly and liquid manner, while many other markets were "frozen." And our specific experience was that only a relatively small number of our index investors sold out of their positions in those tumultuous times, since they had on deposit the collateral to support their positions and did not have to use additional resources to meet margin calls.

We also note that the application of position limits to diversified commodity index funds and financial intermediaries are not necessary in order to prevent "excessive speculation" or manipulation attempts because of the nature of such funds and investors in such funds. We believe that an investor who tracks a broad-based fully collateralized index is not speculating on the price increase of a particular commodity but rather is hedging inflation risk and diversifying and reducing his financial risks. For instance, the advent of diversified commodity index funds has led to improved liquidity and more robust price discovery further out on the forward curve for many commodities, where many producers wish to place their hedges. If index investors were constrained, the liquidity needed by hedgers would necessarily be reduced, contrary to the intent of the legislation. As discussed above, PIMCO, on behalf of its clients, plays a valuable role in the marketplace by providing longer term, long-side liquidity to the short-side hedging needs of the commercial producers. Without commodity index investors, commercial producers would have to find long-side speculators at higher cost and greater uncertainty.

Therefore, we urge the Commission to clarify that the position limits will not apply to commodity index contracts and to ensure that position limits will not restrict the ability of our financial intermediaries to execute our commodity trading positions. The Commission should preserve the flexibility of investors to invest in the commodity index funds that they so choose, permitting millions of investors who wish to include diversified baskets of commodities in their investment portfolios, on a passive, unleveraged basis, to access experienced fund managers and proven fund investments without being subject to unnecessary restrictions on the aggregate size of all the other independent investors in a fund investment. We note that placing restrictive position limits on financial intermediaries would not necessarily bring newer smaller, funds into the marketplace. Even if these newer, smaller funds did enter the marketplace, they may be less skilled at managing risk, less familiar with complex commodity law and compliance, and may operate at higher costs, which would be a disadvantage to all market participants, including investors and hedgers.

We believe such an outcome would not be consistent with congressional intent. As Chairman Lincoln stated, "I urge the CFTC not to unnecessarily disadvantage market participants that invest in diversified and unleveraged commodity indices. 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.'"[12] We urge the Commission to ensure that commodity index investors and commercial producers are not unnecessarily harmed by the imposition of position limits while using its broad discretion to impose limits that will protect the liquidity and price discovery function of the commodity markets.

Grandfathering

Dodd-Frank provides limited relief to the position limits for futures positions entered into before the enactment of a position limit regime and for swap contracts entered into before the enactment of Dodd-Frank. To eliminate any regulatory inconsistency and legal uncertainty, we urge the Commission to clarify in future rulemakings that it will provide the same grandfathering relief to both futures and swaps (i.e., pre-position limits rule enactment).

Furthermore, we encourage the Commission to clarify that a futures position (or a swap) that is rolled over would still be considered a grandfathered position. Given that PIMCO, on behalf of its clients, does not hold any position in the spot month and manages its positions based on a specific commodity index, PIMCO fund managers must roll their position from the prompt month, by selling the front month and buying the next month of the contract. The rolling of these positions takes place in an orderly process. We believe that the rolling of the contract from the prompt month to the next month does not constitute a liquidation of that position, as the fund must maintain the same economic characteristics of that position, regardless of the month of the contract. The only change that occurs during the roll is the contract month; otherwise the economic value of the position held by the fund manager remains the same. We encourage the Commission to apply a flexible approach to the grandfathering provision, to minimize market disruptions and to reduce incentives for market participants to enter into longer-term swap contracts with much larger risk exposure.

Calculation of Position Limits

Under the Proposed Rules, the position limit for each referenced contract will be set at 10% of open interest in that contract up to the first 25,000 contracts and 2.5% of the remaining contracts, based on the CFTC's determination of "estimated deliverable supply." Noting that the single-month and all-months-combined position limits are not currently in place for energy and metals markets, the Release seeks comment as to whether the CFTC should consider setting limits initially on these commodities at some higher level, such as 10% of the first 25,000 contracts and 5% thereafter of open interest, "to best ensure that hedging activities or price discovery are not negatively affected."[13] While we question the basis for any of these limits, we believe that the CFTC should impose these higher position limits to ensure that hedging activities and the price

---

[12] Id.

[13] 76 Fed. Reg. 4759.

discovery function of the commodity markets are not harmed by the imposition of overly restrictive position limits on these markets. Dodd-Frank requires the CFTC to balance the goals of preventing excess speculation and market manipulation against protecting the liquidity and the price discovery function of the markets. We believe that the CFTC should impose these higher position limits to ensure that hedging activities and the price discovery function of the commodity markets are not harmed by the imposition of overly restrictive position limits on these markets.

With regard to agricultural commodities, the Release seeks comment as to whether the current position limits should be retained, if the CFTC should impose the proposed position limit of 10% of the first 25,000 contracts and 2.5% thereafter (the "10%/2.5% Rule"), or the alternative position limits requested by the Chicago Board of Trade in an April 2010 petition to the Commission.[14] We support the position limits recommended by the Chicago Board of Trade, as we believe that they would better protect the liquidity and price discovery function of the agricultural commodity markets than the current limits. We believe that the imposition of the current limits for agricultural commodities under Phase Two would be disruptive to market participants, particularly if the Commission decides to eliminate the independent account controller exemption, the risk management exemption and requires the aggregation of limits across trading venues.

Furthermore, we are concerned that the Proposed Rules do not address the issue of whether market participants can net positions across commodities, *i.e.*, whether they can hedge one commodity with another. We strongly believe that the Commission should allow netting across commodities when contracts in those commodities are sufficiently correlated. Permitting cross-commodity netting is vital for the netting regime to reflect accurately the actual hedging practices utilized by market participants. Market participants commonly hedge one commodity with another commodity, or even with baskets of other commodities, such as using a mix of crude oil and heating oil to hedge jet fuel. Prohibiting netting across commodities would severely limit the ability of market participants to hedge effectively and would unnecessarily restrict market liquidity.

Finally, we note that the explanatory notes issued by the Commission on setting non-spot-month position limits state, "referenced contracts that are calendar and inter-commodity spread contracts would not be used to calculate open interest figures. However these contracts would be attributed to a trader for position limit compliance purposes." The explanatory notes did not provide an explanation as to why such contracts would not be included in the calculation of open interest, but would be counted for purposes of a trader's position. By doing so, the Commission would reduce the open interest, leading to lower position limits that do not fully reflect market activity in the referenced contracts. Therefore, we believe that the Commission should include calendar and inter-commodity spread contracts that are referenced contracts in its calculations of open interest.

---

[14] CME Group Petition for Amendment of Commodity Futures Trading Commission Regulation (April 6, 2010), available at http://www.cftc.gov/LawRegulation/DoddFrankAct/Rulemakings/DF_26_PosLimits/index.htm.

Conclusion
As stated above, we do not oppose the imposition of the proposed Phase One limits once a factual determination has been made that they are "appropriate" and "necessary," as required by Dodd-Frank. However, we urge the Commission to ensure that market participants are permitted to carry the position limits of their counterparty, whether traditional hedging or investing, and to modify the aggregation provisions in Phase One, as set forth above. We respectfully urge the Commission to postpone the implementation of Phase Two until the Commission has comprehensive information on the swap markets and the Commission can articulate the reasons as to why these position limits will address any issues of manipulation or excessive speculation that are found to exist. Furthermore, we urge the Commission to use its broad discretion under Dodd-Frank to set position limits that, in the words of Chairman Lincoln, differentiate between "trading activity that is unleveraged or fully collateralized, solely exchange-traded, fully transparent clearinghouse guaranteed, and poses no systemic risk and highly leveraged swaps trading."

Thank you again for the opportunity to share our thoughts on the Proposed Rules with the Commission. We are at the disposal of the Commission should it require information and additional insight into the valuable role that commodity index investors serve in the commodities markets.

Thank you, and best regards.

Sincerely,

Brent R. Harris, CFA
Managing Director, PIMCO
Chairman and President, PIMCO Funds