CENTER FOR CAPITAL MARKETS COMPETITIVENESS
OF THE
UNITED STATES CHAMBER OF COMMERCE

DAVID T. HIRSCHMANN
PRESIDENT AND CHIEF EXECUTIVE OFFICER

1615 H STREET, NW
WASHINGTON, DC 20062-2000
202/463-5609 • 202/955-1152 FAX
david.hirschmann@uschamber.com

March 28, 2011

Mr. David Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, NW
Washington, DC 20581

Re: Proposed Position Limits for Derivatives; RIN 3038-AD15 and 3038-AD16

Dear Mr. Stawick:

The U.S. Chamber of Commerce ("Chamber") is the world's largest business federation representing over three million companies of every size, sector, and region. The Chamber created the Center for Capital Markets Competitiveness ("CCMC") to promote a modern and effective regulatory structure for capital markets to fully function in a 21st century economy. The CCMC welcomes this opportunity to provide comment on the Notice for Proposed Rulemaking (the "Proposal") issued by the Commodity Future Trading Commission (the "Commission") on January 26, 2011 regarding Position Limits for Derivatives that extend beyond futures and options contracts to swaps traded over the counter. In brief, the Proposal generally imposes position limits of 25% of the deliverable supply in the spot month and 10% of the average open interest for the first 25,000 contracts of open interest and 2.5% thereafter. It also imposes costly reporting and recordkeeping obligations on derivative users.

The CCMC supports the Commission's fundamental goal of preventing price manipulation and protecting the integrity of the derivatives market. We also commend Commission's attempts to meet the stringent Dodd-Frank deadlines. However, we have significant concerns about various aspects of the Proposal:

- The Proposal precedes the establishment of foundational elements that are necessary for a fully effective regulation. Specifically, the Commission has not yet collected the data, or even fully defined a swap. Moreover, position limits will be arbitrary as the needed information about the swap universe is currently unknown.

- The Proposal will harm the competitiveness of the U.S. derivatives markets and move trading offshore, in clear contravention of the Congressional mandate to prevent price discovery from shifting abroad.

- The rule will result in decreased liquidity and transparency in the markets and impose unnecessary and unwarranted limits on a market participant's ability to hedge their risks with U.S. energy, metals and agricultural markets.

- Exemptions should be given to additional hedgers who do not meet the narrow definition of a *bona fide* hedger.

- The Proposal significantly narrows the application of disaggregation relief without any compelling reasons.

Rulemaking is Premature

The CCMC has serious concerns that this rulemaking is premature as foundational elements have not been set. The Commission has yet to collect the information it needs from the swap market and is still in the midst of promulgating rules for reporting. The Commission must acquire more information on the OTC swap markets before it can correctly set limits. Such data are necessary to provide a comprehensive understanding of the swap markets and individual trader positions. The reporting requirements to gather this data are currently being evaluated, and until this prerequisite step is completed, it is inappropriate for the Commission to set position limits on swaps. Moreover, the Commission has yet to propose rules defining a swap, so to impose limits on a financial instrument whose scope is currently unknown is untimely. Because the order of rules is inappropriately sequenced, one must seriously question the quality of the underlying analysis

conducted in setting position limits for derivatives. Thus, the Commission should consider delaying the establishment and implementation of position limits.

Further supporting a delay in the implementation of this rule is the Commission staff's own inability to present empirical evidence linking excessive speculation to price volatility[1]. In fact, at the January 13, 2011 Commission open meeting, Commissioner Michael Dunn stated that "[p]rice volatility exists in markets that have position limits and in markets that do not have position limits. Price volatility exists in markets that have substantial participation from index funds and markets that do not have any index fund participation whatsoever." While the CCMC is not opposed to position limits that are determined to be necessary and appropriate, the Commission should not impose a position limit regime without concrete economic evidence that excessive speculation exists, it leads to a distortion in commodity prices, and that position limits will solve the problem.

U.S. Competitiveness Will Suffer

Section 737 of Dodd-Frank clearly directs the Commission to consider the impact of the proposed limits on the competitiveness of the U.S. derivative markets and to prevent price discovery from moving abroad.[2] Unfortunately, the Commission's rule proposal pays little attention to the global nature of the commodities at issue. Commodities such as oil, wheat, and gold are all traded around the globe. Our foreign competitors are anxiously optimistic that we might degrade our markets through hasty restrictions on the use of the markets along with very expensive recordkeeping. Even though the Act makes a limited attempt to require foreign boards of trade that link to U.S. contracts to impose position limits, it will be trivially easy for large players to circumvent the U.S. limits by using close foreign substitutes. Unless there is global cooperation on such limits, the limits will be ineffective and the U.S. will be at a disadvantage for no benefit.

---

[1] Interagency Task Force on Commodity Markets, Interim Report on Crude Oil, Washington D.C. (July 2008).

[2] Section 737 states in part:

(2)(C) GOAL.—In establishing the limits required under subparagraph (A), the Commission shall 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.

It is disheartening to see in the massive rule proposal no analysis or even meaningful discussion of position limit policies on other exchanges around the world, or how to achieve global cooperation to police our markets. We understand that the UK Financial Services Authority is months behind the U.S. in considering imposing position limits, and it has yet to affirmatively move forward. In fact, it appears UK policymakers are opposed to position limits. Given the competition between the U.S. and UK major market centers, we view this as an important point to consider. Hasty and ill-conceived limits on the U.S. derivatives markets will undoubtedly lead to a significant migration of market participants to less-regulated overseas markets. Moving to trading venues that are less transparent will ultimately create more systemic risk for participants. In the absence of a coherent global system, the Commission should set the position limits high enough so that they do not send legitimate business overseas and do not subject legitimate users to burdensome paperwork.

Decreased Liquidity and Increased Costs

One of the explicit statutory mandates is to "ensure sufficient market liquidity for bona-fide hedgers."[3] This proposal raises the cost of participating in the derivatives market. As the Commission states, "the compliance cost associated with all of these filings will be substantial." These costs will be passed on to the users of derivatives, who will then pass them on to their customers. Ultimately, consumers bear these costs. The higher compliance costs along with the position limits may well push legitimate hedgers out of the market. This leads to the negative unintended consequences of reducing a market participant's ability to transfer risk and hedge against future prices. With less market participants there could be less liquidity and higher volatility. Speculators provide important risk bearing capacity to commercial participants, provide liquidity, and contribute to price discovery. Liquidity is another essential to prevent a decrease in market size. Less liquidity increases market volatility and costs to businesses, farmers and individuals attempting to manage their risk.

Studies and empirical evidence suggest that hard position limits will not reduce price volatility or prevent market manipulation.[4] Despite the fact that speculators

---

[3] Section (3)(B)(iii).

[4] For example, see Muhammed Shahid Ebrahim "Can Position Limits Restrain Rogue Traders?
", http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1742450, last accessed on March 20, 2011, or Scott Irwin et al. "The Performance of Chicago Board of Trade Corn, Soybean, and Wheat Futures Contracts After Recent Changes in Speculative Limits"available at

have become popular scapegoats for financial distress, they actually provide a very valuable service to futures markets. Speculators facilitate the transfer of risk from commercial participants, provide liquidity, and contribute to price discovery. Liquidity is essential to prevent a decrease in market size which in turn increases market volatility and costs to businesses, farmers, and individuals attempting to manage their risk.

One of the biggest misunderstandings surrounding position limits is that severe limits on speculation would bring down prices. If the Proposal is implemented as written, it could distort markets and actually increase costs to hedgers. These increased costs will likely be passed onto consumers. Additionally, if market participants are unable to mitigate their risk through hedging, they might plant fewer crops or make fewer loans thereby decreasing supply. For example, an airline or shipping company's ability to provide increased route and delivery options at an affordable price is directly tied to hedging fuel costs. To put it simply, if hedging becomes too onerous or too expensive because of position limits, participants may decide not to, or be unable to, hedge their risk at all. That not only increases costs to consumers, but also adds risk to the market.

Other Near Hedgers Should Also Be Exempted

Congress explicitly stated that it does not understand all of the complexities of the issue, and explicitly reiterated in §737 that the Commission has extremely broad exemptive authority.[5] The Commission should use this authority to exempt other beneficial market activity that does meet the narrow definition of a *bona fide hedger*. For example, many large institutions in recent years have begun to invest in commodities futures following studies that show equity like returns and a negative correlation with the stock markets.[6] These positive returns reflect that long investors are acting like insurance companies providing price insurance to producers. These beneficial investors are generally long-term "buy and hold" investors who do not cause the wild

---

http://www.agecon.uiuc.edu/irwin/research/CBOTFuturesPerformance.pdf, last accessed on March 20, 2011.

[5] The law states: '(7) EXEMPTIONS.—The Commission, by rule, regulation, or order, may exempt, conditionally or unconditionally, any person or class of persons, any swap or class of swaps, any contract of sale of a commodity for future delivery or class of such contracts, any option or class of options, or any transaction or class of transactions from any requirement it may establish under this section with respect to position limits.

[6] For example, see Gary Gorton and Geert Rouwenhorst, Facts and Fantasies about Commodity Futures, http://fic.wharton.upenn.edu/fic/papers/06/p0607.htm

swings in price. Yet, they are not exempted as *bona fide* hedgers under the rule. The rule should provide exemptions for such beneficial market participants. These participants could be identified based on their holding periods or portfolio turnover.

Similarly, there are many "near hedgers" who may have direct or indirect holdings in futures contracts to hedge their exposures but whose hedging does not fit the narrow definition of a bona fide hedge. For example, some retail investors view themselves as naturally short oil as a result of their energy needs, so they hold an oil related ETF to hedge their exposure to oil prices. Similarly, some hold a commodity index fund such as an ETF as a hedge against inflation. Many diversified, unleveraged investment funds and accounts that take passive, long-only positions, such as mutual funds and pension plans, do not present the same risks which position limits are intended to address and should be exempt. Again, the Commission should explore methods of identifying such near hedgers and exempt them from the position limits. If the Commission determines it is unable to interpret bona fide hedging in this manner, we encourage the Commission to permit hedging transactions that are "economically appropriate" to mitigating risk.

Disaggregation Relief Narrowed Without Reasonable Justification

The CCMC is also concerned that the Proposal significantly modifies the longstanding, existing disaggregation relief provided by the Part 150 regulations, without any real justification for its modification. The Commission in the past has granted relief from aggregating accounts or positions on the basis of ownership where an independent third party has discretion over trading. However, the Proposal would apply aggregation requirements more aggressively to investors in pooled investment vehicles and withdraws the independent account controller exemption that has long been relied upon by market participants. Although a narrower disaggregation relief is available for non-financial entities, this change represents a material revision to existing Commission policy that is not supported by reported problems or abuses in the commodities markets resulting from activities operating under the current aggregation rule regime. Such modifications will result in the unnecessary aggregation of independently controlled accounts that would bring harmful consequences to investors, investment managers, and the commodities markets.

Conclusion

The CCMC was created before the financial crisis to advocate for financial regulatory reform. We believe that the Proposal, in its current form, will hurt the global competiveness of the financial services industry at a time when growth is most needed. It will also impair the efficiency and effectiveness of U.S. derivatives markets through increased costs to hedgers, which will likely be passed on to consumers. Furthermore, we believe that it will also lead to decreased liquidity that is essential to creating private sector jobs. Thus, the CCMC believes that the Commission should delay rulemaking on position limits until it can acquire more information on the OTC swap markets so the Commission can engage in a full and fair examination of the facts and come to a comprehensive understanding of the issues and unintended consequences that may result from the implementation of this rule. The CCMC stands ready to work with the Commission to achieve a fair and rational implementation of Dodd-Frank's position limit provisions.

Sincerely,

David T. Hirschmann
President and Chief Executive Office
Center for Capital Markets Competitiveness