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Via Online Submission

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

**RE: Position Limits for Derivatives; Proposed Rule 76 FR 4752**

Dear Mr. Stawick:

The Commodity Markets Council ("CMC") appreciates the opportunity to submit the following comments for consideration by the Commodity Futures Trading Commission ("CFTC" or "Commission") on its Notice of Proposed Rulemaking entitled "Position Limits for Derivatives" which would impose speculative position limits on certain contracts in agricultural and exempt commodities.

CMC is a trade association bringing together exchanges and their industry counterparts. The activities of our members represent the complete spectrum of commercial and other users of all futures markets including energy and agriculture. Specifically, our industry member firms are regular users of the Chicago Board of Trade, Chicago Mercantile Exchange, ICE Futures US, Kansas City Board of Trade, Minneapolis Grain Exchange, Inc. and the New York Mercantile Exchange. CMC is uniquely positioned to provide the consensus views of commercial and end users of derivatives. Our comments represent the collective view of CMC members.

The businesses of all our member firms depend upon the efficient and competitive functioning of the risk management products traded on U.S. futures exchanges. Through the Commission's diligent oversight efforts that have fostered Exchange innovation and technology adoption, we have seen the commodity markets grow and prosper. They have become deeper and more liquid, narrowing bid/ask spreads and improving hedging effectiveness and price discovery. Meanwhile, liquidity, technology, clearing quality, price and customer service have driven market selection. All of these developments serve the interests of the trade as well as the public.

After reviewing the Proposed Rule, we are deeply concerned that if it is adopted as currently drafted, market liquidity will be lost. As CMC observed in its December 14, 2010 Pre-Rulemaking Comment Letter on Speculative Position Limits, the CMC and its members generally support the use of position limits, but only where necessary. Speculation by itself is not manipulation, nor is it an inappropriate practice. Indeed, it is an essential component of any futures market, providing the liquidity necessary to ensure the price discovery and risk management functions are achieved. Congress has recognized speculators serve the public interest by assuming risks and providing necessary market liquidity. Commodity Exchange Act ("CEA"), Section 3(a). Imposing unnecessary constraints on speculation through ill-conceived and unauthorized position limits can only damage futures markets and harm their participants. For the reasons articulated below, we urge the Commission to reconsider its proposal.

**1. The Proposed Position Limits are Inconsistent with the CEA**

As amended by the Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), Section 4a of the CEA requires that before position limits are imposed by the Commission, it must find (1) that there has

been “excessive speculation”, and (2) that the excessive speculation has resulted in “unwarranted and unreasonable price fluctuations.” CEA, Section 4a(a)(1). New subsection 4(a)(2) confirms that position limits set thereunder must be established “[i]n accordance to the standards [i.e., the “necessary” findings] set forth in paragraph 1 of this subsection.” Notwithstanding the Commission’s statement that it can impose position limits “...based on its *reasonable judgment* that such limits are necessary,” the CEA is expressly to the contrary. 76 Fed. Reg. 4752, 4754 (Jan. 26, 2011). (emphasis supplied). The Commission’s “reasonable judgment” is a far cry from the statutorily mandated finding that such limits are necessary to prevent “excessive speculation” that has resulted in “unwarranted and unreasonable price fluctuations.”

It is no disappointing that the Commission has eschewed making the prescribed finding; there is simply no credible evidence that would support it. None of the empirical studies, whether conducted by private sector organizations, academic groups or government agencies have been able to identify any connection between “excessive speculation” and price volatility.

The imposition of unnecessary constraints on legitimate speculative trading will only deprive the market of essential liquidity with resulting harm to the U.S. futures markets and their participants in the form of increased bid/offer spreads and reduced opportunities for risk management. Price volatility may actually increase.

Moreover, CMC believes legitimate concerns over potential harm from “excessive speculation” are better dealt with by exchanges through existing market surveillance programs on a contract by contract basis. As we have repeatedly stated, exchanges, in coordination with the CFTC, have developed an expertise in maintaining orderly markets, including setting appropriate reporting levels, position limits and accountability levels relative to energy, metals and agricultural markets. This system provides the flexibility necessary to prevent market-disrupting speculation while preserving transparent and liquid markets.

## **2. The CFTC Position Limit Scheme Is Not “Appropriate”**

Aside from failing to satisfy the statutory requisite for imposing position limits of any sort, the CFTC’s position limit scheme is not “appropriate”, as required by the CEA, in its sequencing and in a number of its key provisions (e.g. types of limits, aggregation rules, and exemption limitations.)

With regard to sequencing, the Commission proposes to set position limits in two phases; first with respect to spot-month limits at levels currently set by DCMs based on deliverable supply, and, much later, with respect to non-spot month limits after it has obtained sufficient position data on physical commodity swaps.

Clearly, this is an approach with the potential to disrupt markets. The present lack of swaps position data, the stated reason for delaying non-spot month limits, applies with equal force to the spot-month limits. The imposition of any position limit regime depends on presently unavailable data from the swaps market. Commissioner Jill Sommers has correctly recognized that absent this missing data, the spot-month limits are unenforceable. The CMC urges the Commission to defer imposition of any new position limits until it has received and thoroughly analyzed the swaps market positional data, and provided that analysis - and where possible, aggregate data - to the public for market participants to digest and understand.

Also, the proposed limits are not “appropriate” because the Commission has failed to consider all the factors the CEA requires it to examine prior to determining what limits, if any, are “appropriate.” For example, new Section 4a(a)(3) identifies four objectives the Commission should, to the “maximum extent practicable”, seek to achieve in setting limits. They include eliminating excessive speculation, preventing market manipulation, squeezes and corners, ensuring sufficient market liquidity for bona fide hedges and not disrupting the price discovery function of the market. The Commission’s proposal addresses only one of these: excessive speculation.

Contrary to the requirements of Section 4a(a)(2)(C), the proposal fails to address the potential that the limits may shift the price discovery function to FBOTs. The result is a position limit scheme that fails to satisfy the mandated statutory process for imposing limits.

Some aspects of the limits proposal may even promote price distortions. One example of this is found in the proposed conditional spot-month limit. A trader can hold up to five times the spot-month limit for cash settlement contracts so long as the trader does not hold any physically delivered contracts in the same commodity. Proposed Regulation 151.4(a)(2). This provision will result in the draining of liquidity from the physically delivered market - liquidity that is critical to the underlying commodity. Absent such liquidity, that market becomes susceptible to sudden price fluctuations, the very ill the CEA, and presumably the Commission, seeks to prevent.

Another example of an inappropriate position limit regulation is the proposed class limits rule. Although the Commission's proposed aggregation rules limits would apply to all futures, options and swaps contracts based on the same underlying commodity and would allow netting of positions against economically equivalent swaps, the class limits proposal would not. This distorts economic reality and leads to absurd results. Holding a trader accountable for a position limits violation when his or her net position could amount to as little as one contract is hardly designed to advance market integrity, liquidity or stability.

Moreover, the Commission's purported justification for class limits (preventing concentration of market power in any one submarket) finds no support in the language of the CEA. Congress never mentions "submarket concentration" as a basis for position limits.

The Commission also requested comment on whether the current position limit levels should be retained for certain agricultural commodities, including soybean, corn, wheat, rice, oats, and other contracts traded on the Chicago Board of Trade ("CBOT"). The Commission has proposed to retain the current limits, subject to adjusting the single-month limit to the current all-months-combined limit, rather than increasing the limits consistent with the formula for other commodities.

In April 2010, CBOT petitioned the Commission to increase the limits in certain contracts based on the open interest formula the Commission has used to establish limits in these contracts since 1992 - the same open interest formula it now proposes to apply to other commodities contracts. The Commission has not yet acted on that petition and its current proposal has offered no justification as to why limits for certain agricultural commodities should be subject to a more restrictive standard than other commodities and remain at levels established based upon open interest in 2004, despite the considerable growth in these markets since that time.

CMC believes that increasing the limits will improve liquidity in these growing markets and enhance the hedging efficiency of the contracts. Therefore, to the extent the Commission finds the imposition of limits necessary and appropriate, we urge the Commission to apply the same formula that it applies to other commodity contracts. Failing to appropriately adjust these limits to reflect market realities will undermine liquidity and impair the performance of contracts which serve as critical hedging vehicles and global pricing benchmarks.

CMC also urges the Commission to maintain position limit parity across the three wheat markets. Disparate limits for the three wheat contracts could significantly impair a market's ability to compete for speculative interest critical to the liquidity requirements necessary to maximize contract utility for commercial market hedgers. Moreover, different limits for the same type (but not necessarily variety) of commodity could dramatically impact the growth or potential for risk mitigating strategies between the contract markets.

### **3. The Commission's Aggregation Policy is Flawed**

The Commission's current aggregation policy, set forth in Part 150, as well as its proposed policy, requires a trader to aggregate positions in accounts in which he or she owns or controls 10 percent or

more of the ownership or equity interest. Part 150.3(a)(4) permits disaggregation by “eligible entities” like CPOs, CTAs, mutual funds, bank and insurance companies where their positions are held in separate accounts of independent account controllers. This makes sense because where the account management is independent, there can be no trading in concert or common effort to affect prices in the same way.

The Commission now seeks to eliminate this long standing exemption that it has found to be effective. Its only justification for this change in the historical rule is that it “may not be appropriate.” Such a flimsy rationale does not satisfy Supreme Court precedent for agency changes that rescind established rules. Such changes will be allowed to stand only if the agency has conducted a “[r]easoned analysis beyond that which may be required when an agency does not act in the first instance.” Motor Vehicle Mfrs. Ass’n of U.S., Inc. v. State Farm Mut. Auto., 463 U.S. 29, 41-42 (1983); W. States Petroleum Ass’n v. EPA, 87 F3d 280, 284 (9<sup>th</sup> Cir. 1996).

The Commission offers no supporting evidence for departure from the prior rule. Its suggestion that the change will not affect many traders is beside the point. The only relevant inquiry is how the change affects the markets and their participants. On this, the Commission is silent. It has completely failed to satisfy the “reasoned analysis” requirement for such a change and thus under Motor Vehicle Mfrs. has been inconsistent with the Administrative Procedure Act.

The Commission’s new aggregation exemption for non-financial entities fares no better. No basis for limiting the exemption to such entities is offered. The observation that aggregation would be inappropriate where “operating companies have complete trading and management independence...” applies with equal force to both financial and non-financial operating entities. Thus, without any reasonable basis to treat one class of companies different from another similarly situated class of companies, the rule is arbitrary and must fall. Independent Petroleum Ass’n of America v. Babbitt, 92 F3d 1248 (D.C. Cir. 1996).

The current CEA regulations deem all positions in accounts for which any trader has a financial interest (10 percent or greater) or otherwise controls or directs trading to belong to that trader. An exception, however, is provided for certain traders who have no knowledge of, or control over, the positions of affiliates, nor direct, day-to-day supervisory authority or control over their trading decisions. Significantly, this exception is self-executing subject only to a call by the CFTC for more information.

Under the Proposed Rule, any entity holding accounts in which it directly or indirectly has a 10 percent or greater ownership or equity interest must aggregate the positions in such accounts. The Proposed Rule provides a limited exemption from the aggregation requirement for “owned non-financial entities” that are independently controlled and managed. Unlike current requirements, however, this exception is not self-executing. Rather it would be effective only after the CFTC has approved the application. Moreover, the Proposed Rule would require entities seeking an exemption from the aggregation requirement to demonstrate in a very detailed application that the owned non-financial entities are independently controlled and managed.

CMC believes that requests for exemptions from the aggregation requirement should be effective when filed because persons and entities filing applications for such exemptions have adequate incentives to do so truthfully and in good faith due to provisions in the CEA that sanction false statements in applications filed under the Act. In particular, CMC believes that civil and criminal liability for filing false reports with the CFTC provide a substantial deterrent to filing inaccurate exemption requests. Moreover, after the CFTC has reviewed an exemption request, it retains the authority to deny the request and to require the market participant to aggregate immediately and unwind any positions in excess of the applicable position limit in a reasonable period of time.

Elsewhere in the Proposed Rule, the Commission provides for a “good faith” exemption from position limits for *bona fide* hedging transactions and for positions established prior to the effective date of Proposed Rule. We believe that the same logic should apply to those who apply in good faith for an

exemption from the aggregation requirement even if the Commission subsequently determines that such applicants are not eligible for such an exemption.

Failure to make exemption requests conditionally effective upon filing may substantially limit the ability of many integrated commodity market participants to operate effectively while their applications are pending because they will be required to aggregate positions during the interim. In addition, the Commission should not require market participants to make a detailed showing of independent management and control in an exemption application. Instead, the Commission should permit market participants to make a more limited showing with an obligation to supplement the application upon request.

The Commission's "identical trading strategies" proposal, Reg. 151.7(d), suffers from the same infirmity. No definition of what constitutes an "identical trading strategy" is provided. The Commission gives as an example a trader who seeks a "large long-only position in a given commodity through specific positions in multiple pools" such as "passively managed index funds." These are the same "index funds" that the Commission determined did not cause commodity price fluctuations. See CFTC Staff Report on Commodity Swaps Dealers and Index Traders (Sept. 2008) at 27-30. Thus, without any apparent basis for the rule, commodity index fund traders will be constrained in their risk management opportunities and valuable market liquidity will be denied.

#### **4. The Bona Fide Hedging Exemption Is Too Narrow and Is Counterproductive**

Limiting the bona fide hedging exemption to positions that are a substitute for a position in the physical market is far too narrow and will result in driving essential liquidity from the market without any corresponding benefit. The Commission was granted broad exemption authority in Dodd-Frank, CEA, Section 4a(a)(7). It should exercise this authority to extend the hedging exemption to market participants who use futures, options and swaps, not for speculative purposes, but to hedge risks in their own businesses. Broadening the exemption's scope in this way is entirely consistent with the goal of eliminating excessive speculation. Indeed, limiting the exemption as the Commission has proposed will force the excluded participants to either speculate on price risks by not hedging or hedge through transactions beyond the CFTC's regulatory authority. In either case, costs to the ultimate consumers will likely increase and markets will be deprived of essential liquidity. As such, the CMC urges the Commission to broaden the definition of the bona fide hedging exemption to accommodate non-speculative legitimate commercial hedging transactions.

Proposed Rules 151.5 and 151.10 require any market participant with a position that exceeds the applicable position limits to file with the CFTC before 9:00 a.m. on the following business day numerous items of information regarding the trader's cash market and derivative portfolios. This contrasts with the current practice of allowing traders to apply for hedge exemptions in advance of exceeding position limits. By eliminating the ability of market participants to apply for a hedge exemption in advance, the Proposed Rules will make it more difficult for market participants to plan ahead to meet their *future* hedging needs. Moreover, CMC believes that imposing a daily reporting requirement will be extremely burdensome for many market participants, and we respectfully submit that the Commission has underestimated the economic and operational burdens associated with the Proposed Rule and, more importantly, has not demonstrated that such costs would be justified by any corresponding benefits to the integrity, liquidity, or competitiveness of the U.S. derivatives markets.

Aside from the operational difficulties involved in assembling, synthesizing, and reporting such data on a daily basis, the requirement to apply for an exemption after, rather than in advance of, exceeding a position limit would complicate the efforts of market participants to accommodate both their short-term and long-term hedging needs. If the Commission decides not to provide an avenue for seeking an exemption prior to exceeding a position limit, CMC recommends that the Commission only require market participants with a position that exceeds the applicable position limits to file with the CFTC when they first exceed the position limit, and then to provide reports on a monthly, rather than daily, basis.

An initial, then monthly, reporting process would be considerably less burdensome for market participants, and would provide the CFTC with substantially the same information on exempt hedge positions. Such a reporting procedure also would be consistent with current hedge exemption procedures used by the Commission and the exchanges in Part 19 of the Commission's rules for series '04 reports, which do not require market participants to report their positions on a daily basis.

#### 5. A Final Thought

The CMC appreciates the hard work and effort the Commission and its staff have put into the drafting of proposed rules under the mandates of Dodd-Frank. Nonetheless, those impacted by the proposals are entitled to receive a clearly articulated basis in law and evidence for proposed rules. Absent that, meaningful comment on them is impossible. Regrettably, the position limits proposals, whether from haste or other reasons, have provided market participants and consumers only vague and incomplete rationales for their adoption. Absent the finding that speculative position limits are necessary, CMC urges the Commission to reconsider its proposal. If the Commission moves forward with a proposal, we urge the CFTC to withhold implementing position limits until sufficient swaps market data is available and fully understood so the Commission can provide the detailed basis in law and evidence for its proposal.

The CMC thanks the Commission for the opportunity to present its views on this most important subject. If you have any questions or would like to discuss further, please do not hesitate to contact me via email at [christine.cochran@commoditymkt.org](mailto:christine.cochran@commoditymkt.org) or via phone at (202) 842-0400 - ext. 101. Thank you in anticipation of your attention to these comments.

Regards,

A handwritten signature in black ink, appearing to read "Christine M. Cochran". The signature is written in a cursive style with a large, stylized initial "C".

Christine Cochran  
President