



March 28, 2011

**Via Electronic Mail:** <http://comments.cftc.gov>

David A. Stawick  
Secretary  
Commodity Futures Trading Commission  
1155 21<sup>st</sup> Street, N.W.  
Washington, D.C. 20581

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

Dear Mr. Stawick:

Managed Funds Association (“MFA”)<sup>1</sup> appreciates the opportunity to comment on the Commodity Futures Trading Commission’s (the “Commission”) Notice of Proposed Rulemaking on Position Limits for Derivatives, which proposes to implement federal speculative position limits for futures, option, and swap contracts in or linked to certain agricultural, metals, and energy commodities (the “Proposed Rules”).<sup>2</sup> MFA has carefully reviewed the Proposed Rules and is offering its comments to help the Commission draft final rules that balance the Commission’s objectives with legitimate industry concerns.

MFA’s members rely on fair, competitive, and transparent markets that respond to fundamental factors to conduct their businesses. MFA’s members play a vital role in the futures markets by assuming the price risk from commercial participants (hedgers) on both the long and short sides of the market, and by providing liquidity that facilitates risk transfer and price discovery for businesses around the world. MFA’s members participate directly, through investing in other financial entities, and/or by investing in operating companies and financial institutions.<sup>3</sup>

The Commission previously published a Notice of Proposed Rulemaking on Federal Speculative Position Limits for Referenced Energy Contracts in January 2010, which it subsequently withdrew.<sup>4</sup> In

---

<sup>1</sup> MFA is the voice of the global alternative investment industry. Its members are professionals in hedge funds, funds of funds, and managed futures funds, as well as industry service providers. Established in 1991, MFA is the primary source of information for policy makers and the media and the leading advocate for sound business practices and industry growth. MFA members include the vast majority of the largest hedge fund groups in the world, who manage a substantial portion of the approximately \$1.9 trillion invested in absolute return strategies. MFA is headquartered in Washington, D.C., with an office in New York.

<sup>2</sup> 76 Fed. Reg. 4752 (Jan. 26, 2011) (the “Notice”).

<sup>3</sup> For example, some of MFA’s members invest in non-financial operating companies whose business involves the production, refining, merchandising, or processing of energy and entities engaged in the development of energy market infrastructure (such as production, transportation, or storage of energy), and thus have an interest in enabling such entities to access liquid price discovery and risk-shifting markets. MFA’s members also may invest in financial institutions, whose business may involve the use of the futures markets for risk management purposes.

<sup>4</sup> Federal Speculative Position Limits for Referenced Energy Contracts and Associated Regulations, 75 Fed. Reg. 4144 (Jan. 26, 2010), withdrawn 75 Fed. Reg. 50950 (Aug. 18, 2010) (the “January 2010 Notice”).

MFA's comment letter on the January 2010 Notice, we expressed several broad concerns about the proposed position limits, including that (i) research and experience demonstrate that position limits have not reduced price volatility or prevented market manipulation, and it was not clear how the proposed federal limits would achieve their intended purpose with respect to energy markets; (ii) proposed federal limits likely will result in decreased market liquidity, which in turn would impair the ability of commercial market participants to hedge against rising prices; (iii) restricting trading on U.S. futures markets may drive trading overseas, reducing the competitiveness of U.S. markets; (iv) the costs of the proposed federal limits far outweighed the benefits; (v) the Commission underestimated the number of affected parties, the costs to the market of compliance with the proposed rules and the potential unintended consequences; and (vi) the Commission should have considered the availability of alternative approaches. MFA also provided a number of specific comments on the January 2010 Notice, including (a) the negative effects of the proposed "crowding out" provision in the spot month; (b) the need to preserve the existing disaggregation relief for independently controlled accounts; (c) the need for greater transparency in the calculation of open interest and deliverable supply; (d) flaws in the methodology for annual recalculation of position limits; and (e) the advisability of an exemption for inter-commodity spread transactions.<sup>5</sup>

While MFA appreciates that the Commission has not included a "crowding out" provision in the Proposed Rules, MFA believes that many of its prior concerns with the January 2010 Notice are still applicable to the Proposed Rules.

As the Commission considers final rulemaking, we respectfully urge it to gather and examine carefully all relevant data and consider less onerous alternatives. Rulemaking relating to position limits should be empirically driven and not a response to popular sentiment or partial analyses. Unnecessary and sweeping changes to the current effective position limit framework can become a vehicle for costly, detrimental, and unintended consequences, and can severely impair the efficient functioning and competitiveness of U.S. derivatives markets. MFA concurs with the statement of Commissioner Dunn, "To date, CFTC staff has been unable to find any reliable economic analysis to support either the contention that excessive speculation is affecting the markets we regulate or that position limits will prevent excessive speculation. The task then is for the CFTC staff to determine whether position limits are appropriate. With such a lack of concrete 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."<sup>6</sup>

## **I. EXECUTIVE SUMMARY**

MFA has carefully considered the Proposed Rules and is providing its comments and recommendations, which are summarized as follows:

- The Commission's proposed limits do not strike the right balance amongst the prescribed statutory goals of diminishing excessive speculation and deterring market manipulation, and ensuring sufficient market liquidity for bona fide hedgers and the price discovery function of the underlying market. Research and experience demonstrate that position limits have not reduced price volatility or prevented market manipulation. Rather, research shows that such limits may negatively impact

---

<sup>5</sup> Letter from Richard H. Baker, President and CEO, Managed Funds Association, to David A. Stawick, Secretary, Commodity Futures Trading Commission (Apr. 26, 2010) available at: <http://www.managedfunds.org/downloads/MFA%20CFTC%20energy%20spec%20limits.4.26.10.pdf>.

<sup>6</sup> Opening Statement of Commissioner Michael V. Dunn, Commodity Futures Trading Commission Open Meeting (January 13, 2011).

market liquidity and price discovery. MFA believes that the position limits proposed in the Proposed Rules will place a greater burden on interstate commerce by hindering the ability of futures markets to perform their fundamental price discovery, risk transfer, and risk management functions, which depend on the existence of liquid, fair, and competitive markets. Moreover, absent coordination with foreign regulators and boards of trade, the imposition of position limits on U.S. markets may shift liquidity to foreign markets.

- The Commission's proposed limits are a flawed cure for a problem that the Commission has not found to exist. Even if the Commission were to find excessive speculation in the commodity markets, there are several defects in the Proposed Rules. For example, the annual recalculation methodology for Commission determination of non-spot month position limits results in a bias towards lower annual limits.
- The Commission's proposed changes to the disaggregation rules will result in unnecessary aggregation of independently controlled accounts, burden investors and investment managers, and potentially reduce liquidity in U.S. futures markets. Disaggregation based upon independence of control has been a longstanding policy of the Commission and U.S. futures exchanges. This policy was adopted gradually and refined over time in a carefully considered and open process. Because the current policy is effective, the Commission's proposed changes are unnecessary and may have severe unintended consequences.
- The proposed spot-month limits on cash-settled contracts are not supported by any data that establishing such limits by reference to 25% of deliverable supply is appropriate or that further limiting the reference to a specific delivery point is justified. Alternative approaches should be considered to ensure that liquidity is not diminished in these widely-used risk management contracts.
- The Commission should restore the inter-commodity hedge and arbitrage exemptions that the Proposed Rules appear to have deleted, which are central to managing risk and maintaining balanced portfolios.
- MFA has a number of additional concerns and suggestions regarding: (i) the proposed individual class rules, which will impose costly administrative and compliance burdens; (ii) the proposed legacy position limits for agricultural commodities, which should be replaced by limits calculated in the same manner as limits for other commodity categories under the Proposed Rules; (iii) the proposed pre-existing position exemption rules, which may result in disorderly markets when the positions are liquidated and the full position cannot be rolled forward; (iv) the proposed position visibility rules, which may impose costly burdens on market participants to produce data on an ongoing basis when it is not clear that the Commission has the capacity to readily evaluate or utilize such data; (v) the proposed issuance of separate rulemaking for limits relating to significant price discovery contracts that are linked to the referenced contracts and how it will be integrated with the position limit framework of the Proposed Rules; (vi) the use of rounding in calculating position limits; and (vii) obtaining greater clarity as to the application of the proposed limits.

## **II. THE PROPOSED RULES**

The Proposed Rules would:

A. Establish spot-month position limits for certain agricultural, metals, and energy commodities contracts (defined as "referenced contracts") initially at the levels currently imposed by

designated contract markets and later at levels equal to 25% of deliverable supply, as determined by the Commission.

B. Establish aggregate (i.e., aggregating futures, options, swaps, or swaptions in each contract) spot-month position limits for referenced contracts. The spot-month position limits initially would be set at the levels currently imposed by DCMs (i.e., 25% of deliverable supply). The spot-month limits would be applied separately for physically delivered and cash-settled contracts.

C. Establish a conditional-spot month limit that will permit traders without a hedge exemption to acquire position levels in cash-settled contracts that are five times the spot-month limit if such positions are exclusively in cash settled contracts and provided that the trader: (i) for cash-settled contracts in the spot month, does not hold or control positions in cash-settled contracts in the spot month that exceed the position limit; (ii) does not hold or control positions in the physical delivery referenced contract based on the same commodity that is in such contract's spot month; (iii) holds 25 percent or less of cash or forward positions in the referenced contract's underlying physical commodity deliverable at the location specified in the futures contract in the same commodity; and (iv) has submitted a certification to the Commission.

D. Adopt six classes of non-spot-month position limits: (i) aggregate (i.e., futures class and swaps class) all-months-combined; (ii) aggregate single-month; (iii) futures class all-months-combined; (iv) futures class single-month; (v) swaps class all-months combined; and (vi) swaps class single-month. The non-spot-month position limits would be tied to a specific percentage of overall open interest for a particular referenced contract in the aggregate or on a per class basis. The non-spot position limits would be set as the sum of (i) 10% of the first 25,000 contracts; and (ii) 2.5% of open interest beyond 25,000 contracts. Under this approach, the Commission would eliminate the calendar-spread exemption within single-month limits.

E. Adopt a new, more restrictive, definition of bona fide hedging transaction for referenced contracts that requires the hedging transaction to represent cash market transactions and offset cash market risks, rather than transactions that would normally, but not necessarily, represent a substitute for cash market transactions or positions. The bona fide hedging transaction definition also includes a new swap dealer hedge exemption for swaps entered into by a dealer with counterparties wherein the swap would qualify as a bona fide hedge for the counterparty.

F. Adopt existing account aggregation standards that would require aggregation of all positions in accounts in which any trader, directly or indirectly, has an ownership or equity interest of 10 percent or greater or, by power of attorney or otherwise, controls trading. These proposed aggregation rules, however, curtail the longstanding current exemptions for positions in pools held by a pool participant and eliminate the longstanding current independent account controller exemption. The proposed aggregation rules include three exemptions from aggregation:

1. A limited exemption for positions in pools in which a participating person has an ownership of between 10% and 25%, if the person does not have control over or knowledge of the pool's trading.

2. A limited exemption for positions of futures commission merchants ("FCMs") or their separately organized affiliates in certain discretionary accounts if they maintain only minimum control over trading in the relevant account and if the trading decisions of that account are independent from the trading decisions in the FCM's other accounts.

3. A limited exemption for entities to disaggregate the positions of an independently controlled and managed trader, that is not a financial entity, in which it has an ownership or equity interest of 10% or greater, and for which it provides a description of the indicia that demonstrate independent control and management to the Commission.

Exemptions from the account aggregation requirements are no longer self-executing. Each of the above three exemptions requires an application to, and affirmative approval of, the Commission. Additionally, each exemption must be renewed on an annual basis.

G. Retain the all-months-combined position limits for enumerated agricultural commodities as an exemption from the open interest formula for calculating position limits. The single-month limit for these contracts would be increased to the same level as the legacy all-months-combined limit, with the elimination of the calendar spread exemption.

H. Establish position visibility and reporting requirements for referenced contracts other than referenced agricultural contracts (i.e., energy and metals).

I. Provide a limited exception for positions in futures or options contracts on a DCM that are in excess of the position limits at the time they are implemented. Traders would not be permitted to enter into new contracts in the same direction, but could enter into offsetting positions.

J. Provide that the aggregate position limits would apply to a trader's positions in referenced contracts executed on or subject to the rules of a foreign board of trade.

The Commission is proposing to establish the limits in two phases, which could involve multiple final regulations or different implementation dates. In the first transitional phase, the Commission is proposing to establish spot-month position limits at the levels currently imposed by DCMs. This first phase would include related provisions, such as proposed regulation 151.5, pertaining to bona fide hedging, and proposed regulation 151.7, pertaining to account aggregation standards. During the second phase, the Commission is proposing to establish single-month and all months-combined position limits and to set Commission-determined spot-month position limits.

### III. COMMENTS

#### A. BALANCE OF STATUTORY OBJECTIVES

*The Commission's proposed limits do not strike the right balance among the prescribed statutory goals of diminishing excessive speculation and deterring market manipulation and ensuring sufficient market liquidity for bona fide hedgers and the price discovery function of the underlying market.*

Section 4a(a)(1) of the Commodity Exchange Act (the "Act"), as amended, sets forth the Commission's broad authority to set such position limits as the Commission finds are necessary to diminish, eliminate, or prevent such burden to interstate commerce caused by excessive speculation that causes sudden or unreasonable fluctuations or unwarranted changes in the price of such commodity. Section 737 of the Dodd-Frank Act<sup>7</sup> added Sections 4a(a)(2) through (7) to the Act. Section 4a(a)(2) authorizes the Commission, in accordance with the standards set forth in Section 4a(a)(1) described above, with respect to physical commodities (agricultural, metals, and energy, but not excluded

---

<sup>7</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010).



commodities such as interest rates, currencies, or stock indices) to establish limits on the amount of positions, as appropriate, other than bona fide hedge positions. The legislative history of the Dodd-Frank Act indicates that the Commission's setting of position limits is intended to be an authorized, rather than a required, action.<sup>8</sup> Section 4a(a)(3) of the Act specifies that if the Commission establishes the limits in Section 4a(a)(2), it must set limits on the number of positions that may be held by any person for the spot month, each other month, and the aggregate number of positions that may be held by any person for all months, 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.<sup>9</sup>

Although the Dodd-Frank Act provides the Commission with discretion and does not specify what weight the Commission must give to each of the four factors above when setting limits, the Dodd-Frank Act requires the Commission to maximize to the extent practicable each of the four factors when setting limits. Congress requires balance in establishing limits, and in seeking to further one objective (e.g., preventing excessive speculation), the Commission needs to do so in a manner that does not adversely affect another objective (e.g., ensuring liquidity). MFA believes that the Commission has not struck the appropriate balance among these four criteria, but instead has focused on addressing the fear of excessive speculation and market manipulation at the expense of ensuring sufficient market liquidity and price discovery. Further, MFA believes that the Commission has not adequately considered whether the Proposed Rules will cause price discovery in the referenced commodities to shift to trading on foreign boards of trade, as required under Section 4a(a)(2)(C) of the Act.<sup>10</sup> The referenced contracts are global commodities that are traded worldwide; therefore, the Commission should not implement rulemaking until there is global cooperation on position limits, otherwise U.S. markets will be disadvantaged.

MFA believes that, when the Commission exercises its regulatory oversight authority, it must be cognizant of the effect of the proposed federal limits on the ability of futures markets to perform their fundamental price discovery, risk transfer, and risk management functions, which depend on the existence of liquid, fair, and competitive markets. Therefore, any proposal that would tend to adversely affect the liquidity, fairness or competitiveness of the futures markets must be carefully scrutinized. Throughout this letter, MFA suggests certain revisions to the Proposed Rules intended to better balance the statutory policy objectives and to permit the Commission to fulfill its statutory mandate to protect the integrity of the market, but in a manner that is less disruptive to the liquidity of the market and to the operations of market participants.

---

<sup>8</sup> See S. Rept. 111-176 (Apr. 30, 2010), "This section authorizes the CFTC to establish aggregate position limits across commodity contracts listed by designated contract markets, commodity contracts traded on a foreign board of trade that provides participants located in the United States with direct access to its electronic trading and order matching system, and swap contracts that perform or affect a significant price discovery function with respect to regulated markets." (emphasis added.)

<sup>9</sup> Section 4a(a)(5) of the Act requires the Commission to establish limits on the amount of positions, as appropriate, other than bona fide hedge positions, that may be held by any person with respect to swaps that are economically equivalent to futures or options contracts traded on a DCM. In establishing these limits, the Commission must address similar requirements as those described in Section 4a(a)(3) described above.

<sup>10</sup> Section 4a(a)(2)(C) states "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."

Section 4a(a)(7) of the Act permits the Commission to exempt any person or class of person, any swap or class of swaps, any futures or option contract, or any transaction or class of transactions from any requirement it may establish under Section 4a(a)(1). Congress granted the Commission broad, essentially unlimited, discretion to exempt traders and contracts from the position limit requirements. MFA believes that, to the extent the application of position limits to a particular class of trader or contract would not further *all* of the four factors above, the Commission should use its exemptive authority to reach the appropriate balance among the four criteria.

*Excessive speculation has not been the cause of sudden or unreasonable changes in the price of commodities.*

MFA notes that extensive studies have been undertaken by public and private institutions around the world on the energy price volatility of 2007-2008, seeking to identify and explain the underlying factors. MFA has found that the vast majority of reputable research and commentary from a range of sources including, for example, the Commission,<sup>11</sup> the GAO,<sup>12</sup> IOSCO,<sup>13</sup> the IMF,<sup>14</sup> the UK Treasury,<sup>15</sup> CME,<sup>16</sup> *The Economist*,<sup>17</sup> academics,<sup>18</sup> and market participants<sup>19</sup> has concluded that fundamental factors of supply and demand, along with economic factors such as the decline in the U.S. dollar, were primarily responsible for price volatility. To illustrate this conclusion, between December 31, 2007 and June 30, 2008, when the NYMEX Crude Oil price rose from \$96 to \$140 per barrel, open interest rose from 2.5 million to 2.8 million contracts, but the commodity index investment (i.e., speculative investment) fell from 408,000 to 363,000 open long contracts. Commission staff summarized this result stating: “While the net notional value of commodity index business in NYMEX WTI crude oil increased sharply over the 6-month period ending on June 30, 2008—by about 30 percent, the actual numbers of equivalent long futures contracts declined over that same period by about 11 percent. In other words, the sharp rise in the net notional value of commodity index business in crude oil futures appears to be due to an appreciation of the value of existing investments caused by the rise in crude oil prices and not the result of more

---

<sup>11</sup> CFTC Inter-Agency Task Force on Commodity Markets—Interim Report on Crude Oil (July 2008).

<sup>12</sup> GAO Briefings to the House Committee on Agriculture on Issues Involving the Use of Futures Markets to Invest in Commodity Indexes (Dec. 2008).

<sup>13</sup> International Organization of Securities Commission’s Technical Committee (IOSCO) Final Report (Mar. 2009).

<sup>14</sup> IMF World Economic Outlook (Oct. 2008).

<sup>15</sup> HM Treasury Global Commodities: A long term vision for stable, secure and sustainable global markets (June 2008).

<sup>16</sup> CME Group white paper “Excessive Speculation and Position Limits in Energy Derivatives Markets,” available at <http://cmegroup.com/company/files/PositionLimitsWhitePaper.pdf>.

<sup>17</sup> *Dr Evil, or drivel? The charge-sheet against commodity speculators is flimsy*, *Economist*, November 11, 2010 (“In fact there is little empirical evidence that investors cause more than fleeting distortions to commodity prices. The most persuasive explanation for the rises and falls of commodities is demand and supply.”).

<sup>18</sup> Irwin, Scott. H., and Sanders, Dwight R. (2010), *The Impact of Index and Swap Funds on Commodity Futures Markets: Preliminary Results*, OECD Food, Agriculture and Fisheries Working Papers, No. 27, OECD Publishing.

<sup>19</sup> “With Better Data, Better Understanding” (Jan. 27, 2009); Lawrence Eagles, J.P. Morgan.

money flowing into commodity index trading.”<sup>20</sup> There was no evidence to indicate that excessive speculation was to blame, as speculators were actually reducing their long positions during this period.<sup>21</sup>

What is often ignored are the benefits that speculators provide to the market. Speculators such as some hedge funds absorb risk from hedgers and provide liquidity to both sides of the market.<sup>22</sup> Producers and users rarely meet directly, given the different sizes, durations, and specifications of their needs, and instead rely on speculators to take the opposite position. In a recent study by the OECD, research found that there was a negative correlation between speculative positions and market volatility, concluding that “there is some consistent evidence that increases in trader positions are followed by lower market volatility.”<sup>23</sup> This follows on studies by Haigh, Hranaiova and Overdahl, which found that “hedge funds [do] not affect price levels in energy futures markets, yet[...]are very important to the functioning of the market through the liquidity they provide to other participants,” and by Commission staff, which observed that “hedge fund trading activity is beneficial in that it contributes to bringing in line the prices of commodity futures at different maturities.”<sup>24</sup> The availability of speculators to take long and short positions, bring in new information, and express countervailing views, helps complete the market for hedgers, smooth out volatility, and aid in price discovery. While the term “speculator” is an age-old technical designation, it has unfortunately taken on pejorative connotation in recent years, which detracts from this important role.

Position limits, even purportedly generous ones, may impair the ability of markets to serve their essential risk shifting function, which would increase the cost of managing risk and harm hedgers, and ultimately consumers of these products. Studies have demonstrated that on prior occasions where trading by investors was restricted, such as by prohibiting futures transactions in certain commodities (Chicago onions, Berlin wheat), the result was significantly greater, and not less, price volatility.<sup>25</sup> Studies

---

<sup>20</sup> CFTC Staff Report on Commodity Swap Dealers & Index Traders (Sept. 2008).

<sup>21</sup> See, e.g., “Commodity Price and Futures Positions” (Dec. 16, 2009), Ruy Ribero, Lawrence Eagles and Nicholas von Solodkoff, J.P. Morgan; “We can safely say there is no indication in this data of the fact speculators are pushing the price of oil,” Christophe Barret, global oil analyst at Credit Agricole, quoted in Energy Risk (Apr 13, 2010), available at <http://www.risk.net/energy-risk/news/1600919/cftc-speculators-influence-commodity-markets>; Prepared Testimony of Philip K. Verleger, Jr., Haskayne School of Management, University of Calgary, PKVerleger LLC, to Commodity Futures Trading Commission on The Role of Speculators in Setting the Price of Oil (Aug. 5, 2009); “Speculators Cleared in U.K. Oil Volatility” (July 28, 2009), *The Wall Street Journal*; and CFTC Interagency Task Force on Commodity Markets, Interim Report on Crude Oil, *supra* note 11.

<sup>22</sup> “The short hedgers and long investors provide liquidity for each other by using futures markets to serve their respective interests in a open, transparent and efficient manner. Liquidity will be essential to make sure each can achieve their objectives at an efficient price. Artificial limits on that liquidity should not be imposed. There are numerous ways to further the objectives of enhanced transparency and reduced systemic risk that do not involve reductions in much needed liquidity.” Prepared Statement Before the Commodity Futures Trading Commission of Kevin Norrish, Managing Director of Commodities Research, Barclays Capital (March 25, 2010).

<sup>23</sup> Irwin, S. H. and D. R. Sanders (2010), “The Impact of Index and Swap Funds on Commodity Futures Markets: Preliminary Results”, OECD Food, Agriculture and Fisheries Working Papers, No. 27, OECD Publishing. doi: 10.1787/5kmd40w11t5f-en.

<sup>24</sup> See Büyüksahin, Haigh, Harris, Overdahl and Robe, Fundamentals, Trader Activity and Derivative Pricing (December 4, 2008), available at: <http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/marketreportenergyfutures.pdf>.

<sup>25</sup> “At a minimum, there is no evidence for the claim that futures markets are associated with higher price volatility. Indeed, the results presented in this paper strongly suggest the opposite: futures markets were associated with, and most likely caused lower commodity price volatility.” “Populists versus theorists: Futures markets and the volatility



comparing price volatility in various commodities (wheat, cotton, oats, sugar, butter, eggs, rubber, silk, copper, silver, lead, zinc, soybeans, linseed, and hogs) before and after the establishment of futures markets for such commodities also demonstrate that futures markets are associated with lower price volatility.<sup>26</sup> Longstanding research, including studies conducted by the Commission, has shown that speculators and index funds perform an essential function in the commodity markets by transferring risk from commercial participants, providing liquidity, reducing volatility, and contributing to the price discovery process, which benefits hedgers and all consumers and producers of the commodities.<sup>27</sup> In a recent study by OECD, research found that there was a negative correlation between positions and market volatility, “there is some consistent evidence that increases in trader positions are followed by lower market volatility.”<sup>28</sup>

MFA argues that the best available evidence discounts the theory that there is excessive speculation distorting the prices in the commodity markets. Accordingly, we believe that it would be inappropriate to adopt the Proposed Rules given the weight of the evidence and that the position limits proposed in the Proposed Rules will place a greater burden on interstate commerce by hindering the ability of futures markets to (i) ensure that the price discovery function of the underlying market is not disrupted; and (ii) perform their fundamental risk transfer and risk management functions, both of which depend on the existence of liquid, fair and competitive markets to ensure sufficient market liquidity for bona fide hedgers.<sup>29</sup>

*The Commission’s proposed limits are a flawed cure for a problem that the Commission has not found to exist.*

The Commission asserts that it is not required to find that an undue burden on interstate commerce resulting from excessive speculation exists, or is likely to occur in the future, in order to impose limits. Rather the Commission states that it may impose limits prophylactically to diminish, eliminate, or prevent sudden or unreasonable price fluctuations attributable to excessive speculation.<sup>30</sup> Without necessarily agreeing with this interpretation, MFA believes that the prophylactic steps the Commission proposes are substantially flawed and are potentially harmful to the health of the market.

Although position limits may reduce the ability of persons with market power to squeeze or corner the market, they have been described as a crude and inefficient tool.<sup>31</sup> This is because it is difficult

---

of prices” (June 2006), *Explorations in Economic History* 44 (2007) 342-362, at 357, David S. Jacks (“Jacks Study”), available at [www.sciencedirect.com](http://www.sciencedirect.com).

<sup>26</sup> Jacks Study, at 352.

<sup>27</sup> See, e.g., “A Review of Recent Hedge Fund Participation in NYMEX Natural Gas and Crude Oil Futures Markets”, New York Mercantile Exchange, Mar. 1, 2005; “Price Dynamics, Price Discovery and Large Futures Trader Interactions in the Energy Complex, Working Paper First Draft: April 28th 2005”, Michael S. Haigh, Jana Hranaiova, and James A. Overdahl, Office of the Chief Economist, U.S. Commodity Futures Trading Commission (“Commission Energy Complex Report”); Testimony of Craig Pirrong, Professor of Finance, Director, Global Energy Management Institute, Bauer College of Business, The University of Houston, Before the House Committee on Agriculture (July 7, 2008) (“Pirrong Testimony”); Jacks Study at 342-362.

<sup>28</sup> See Irwin and Sanders, *supra* note 7.

<sup>29</sup> See, e.g., Pirrong Testimony, at 3.

<sup>30</sup> 76 Fed. Reg. at 4754.

<sup>31</sup> Pirrong Testimony, at 5.

to set the limits at a level that inhibits market manipulation without unduly affecting the ability of markets to efficiently transfer risk. We recommend alternatives to using such a blunt instrument.

Furthermore, the annual recalculation methodology for Commission determination of non-spot month position limits, which is based on open interest, is flawed because it contains a built-in bias towards lower annual limits. Given the potentially severe consequences of violating a position limit, many traders currently build in a cushion to stay under position limits. Anecdotal evidence suggests this cushion typically may be 10% or more. As a result, assuming that no new investors enter the markets, the result will be overall lower open interest once the new position limits go into effect. Because the position limit levels will be reset annually by looking back at prior open interest levels, this may result in the following year having a lower position limit level and create a self-reinforcing cycle of lower open interest and lower position limits in successive years.

In addition, open interest can change dramatically from year to year depending on external events, such as regime change in the Middle East, significant changes in weather or economic events, that impact prices. If a slow year is followed by a more active year due to these events, the position limits will limit liquidity when it is most needed. For example, due to recent events in Egypt and Libya, open interest in NYMEX WTI has reached record levels.<sup>32</sup> Limits based on open interest from 2010 may limit liquidity.

The proposed federal limits are modeled after the current federal speculative position limits applicable to agricultural commodities. However, the Commission offers no empirical support for the proposition that position limits have reduced undue price volatility in agricultural commodities or will reduce volatility in energy or metals markets.<sup>33</sup> As Commissioner O'Malia observed, it is not clear that position limits in the agricultural markets have prevented price spikes in those markets.<sup>34</sup> Moreover, the Commission does not explain why the agricultural model would be correctly applied to energy and metals in view of the different characteristics that distinguish these markets. For example, the energy and metals markets are more global, energy and metals commodities are more fungible, supplies of energy and metals commodities are much greater, and energy commodities production is subject to less seasonal variation than agricultural commodities.

MFA believes that the proposed position limits, aggregation rules, and restrictive exemptions will potentially reduce liquidity in U.S. futures markets. Aside from the overall imposition of position limits, there are several other aspects of the Proposed Rules that we believe will significantly impact liquidity in the derivatives markets. Additionally, MFA questions whether the Commission's approach will promote the goal of preserving market integrity. If the imposition of position limits on U.S. futures exchanges drives more trading to other markets, the Commission will have more difficulty conducting effective market surveillance and preventing potential price manipulation in the underlying commodities.

---

<sup>32</sup> Press Release, CME Group, CME Group Announces Three Consecutive Open Interest Volume Records in Benchmark Light Sweet Crude Oil (WTI) Futures (March 14, 2011).

<sup>33</sup> “[W]e do not believe a case has been made which demonstrates that prices of commodities, or other financial derivatives, can be effectively controlled through the mandatory operation of regulatory tools such as position limits, whether on exchange or OTC. Analysis of market data where position limits are already in use suggests this has not shown a reduction in volatility or absolute price movements compared to contracts where they are not.” Financial Services Authority & HM Treasury, Reforming OTC Derivative Markets, A UK perspective (“FSA & HM Treasury Report”) (Dec. 2009), at 34.

<sup>34</sup> January 2010 Notice, at 4172.

We believe there are better alternatives than position limits to deter market manipulation. Through the use of the current position reporting and market surveillance regime, and the ability to impose penalties for violations, the Commission and exchange surveillance staff can detect and prevent corners, squeezes, and other forms of manipulation. It is preferable, therefore, to use readily available market data and the Commission's statutory authority to investigate and prosecute aggressive traders that manipulate or attempt to manipulate the market, than to limit the trading activity of all other market participants through position limits. An effective enforcement regime will discourage manipulation and assure a proper balance – preventing excessive speculation and deterring market manipulation, while ensuring sufficient market liquidity and price discovery.

## **B. DISAGGREGATION RELIEF**

*The Commission's proposed limits on disaggregation relief will result in unnecessary aggregation of independently controlled accounts, burden investors and investment managers, and potentially reduce liquidity in U.S. futures markets.*

*The Commission has a longstanding, successful policy of disaggregation based upon independent control. There is no compelling reason to change this policy and prohibit previously eligible entities from aggregating positions.*

Disaggregation based upon independence of control has been a longstanding policy of the Commission and U.S. futures exchanges.<sup>35</sup> The Commission historically has required aggregation of positions on the basis of ownership of positions or control of trading decisions. For this purpose, a trader holding accounts or positions in which the trader directly or indirectly has a 10% or greater ownership or equity interest generally must aggregate all such accounts or positions. Over the years, by regulation and interpretative letters, the Commission has provided relief from having to aggregate accounts or positions on the basis of ownership where discretion over trading is granted to an independent third party. The premise of such relief is that the beneficial owner in these cases does not directly or indirectly control the trading of the accounts or positions involved, and often is unaware of orders executed until a significant period of time has elapsed.

The Commission has not pointed to any problems or abuses in commodity markets arising out of the application of the current aggregation rules and exemptions permitting disaggregation that would suggest the current rule is inadequate. Indeed, the Commission states “[a]t this time, the Commission does not see sufficient justification to change its longstanding approach of considering both control and ownership in its aggregation policy. The traditional ten percent ownership standard has proven to be a

---

<sup>35</sup> See, e.g., the Aggregation Policy (exemption from aggregation for futures commission merchant managed account programs utilizing independent commodity pool operators); Adoption of Commission Regulation 150.3(a)(4), 53 Fed. Reg. 415653 (Oct. 24, 1988) (extending the Aggregation Policy exemption for multi-advisor commodity funds); Exemption From Speculative Position Limits for Positions Which Have a Common Owner, But Which Are Independently Controlled, 56 Fed. Reg. 14308 (Apr. 9, 1991) (extending the exemption to commodity trading advisors); Amendment of Commission Regulation 150.3, 57 Fed. Reg. 44492 (Sept. 28, 1992) (making the exemption for eligible entities self-executing); CFTC Interpretative Letter No. 92-15 (where an FCM is one of the components of a larger organization, the Aggregation Letter exemption would apply, even where the CPO/CTA were being operated as a separate subsidiary of a common parent); Amendment of Commission Regulation 150.1(d) and 150.4, 64 Fed. Reg. 24038 (May 5, 1999) (to expand the categories of eligible entities that authorize independent account controllers to trade on their behalf to the separately organized affiliates of an eligible entity); and CFTC Regulation 150.4(c) (disaggregation for ownership by limited partners, shareholder or other pool participants). See also NYMEX Rule 559.E.

useful measure in conjunction with the control standard.”<sup>36</sup> Elsewhere in the Proposed Rules, in proposing rule 151.7, the Commission states that “allowing traders to establish a series of positions each near a proposed position limit, without aggregation, may not be appropriate.”<sup>37</sup> MFA agrees with the Commission that if such traders were trading in concert or were not truly independent, then aggregation would be appropriate. In fact, the current aggregation rules would prohibit such behavior.

*The Current Independent Account Controller Exemption Should Not be Narrowed.*

Under current Commission Rule 150.3(a)(4), a commodity pool operator (“CPO”), commodity trading advisor (“CTA”), bank or trust company, an insurance company, or the operator of a trading vehicle that is excluded or has qualified for an exemption under Commission Regulation 4.5 (each, an “eligible entity”) need not aggregate positions carried for it by an “independent account controller”<sup>38</sup> except in the spot month if there is a spot month limit. If an independent account controller is affiliated with the eligible entity or another independent account controller trading on behalf of the eligible entity, each of the affiliated entities must: (i) maintain written procedures to preclude them from having knowledge of, or gaining access to, trades of the other, including document and order routing arrangements or separate physical locations; (ii) trade such accounts pursuant to separately developed and independent trading systems; (iii) market such trading systems separately; and (iv) solicit such funds by using separate disclosure documents (where such documents are required under Commission rules).

Proposed Rule 151.7 eliminates the current independent account controller exemption. In its place, the Commission adds a limited disaggregation exemption for an entity that owns 10% or more of a non-financial entity whose trading is managed by an independently controlled and managed trader that can demonstrate independent control and management.

The elimination of the independent account controller exemption would eliminate the ability of firms to disaggregate different parts of their business or different passive accounts that follow different investment strategies (unless it qualifies for the owned non-financial entity exemption). For example, an asset manager now may legitimately access multiple active and passive trading programs that are independently managed by independent account controllers. Some programs involve short-term trading strategies, some are long-term, some are based on market fundamentals and some are based on technical signals. Asset managers also may invest through separate accounts or “funds of funds” structures which allow their investors to have access to various and diversified independently managed investment strategies. An asset management firm also may own, in whole or in part, or through private equity investments, utilities, producers of energy, or other energy and energy-related companies, and need to hedge those exposures independently from other trading strategies. The ability to invest in a variety of strategies and obtain access to a variety of independent managers is particularly important to larger passive investors, such as pension plans.

---

<sup>36</sup> 76 Fed. Reg. at 4756.

<sup>37</sup> 76 Fed. Reg. at 4762.

<sup>38</sup> For this purpose an independent account controller is defined as a person who: trades independently on behalf of an “eligible entity” such as a CPO or CTA; over whose trading the CPO or CTA maintains only such minimum control consistent with its duty to supervise diligently the trading done on its behalf; who has no knowledge of any trading decisions by any other independent account controller acting on its behalf; and who is separately registered as a CTA or an associated person of a CTA. Commission Regulation 150.1(d).

The Commission has given no reason to depart from its longstanding exception for independently controlled accounts from its aggregation policy.<sup>39</sup> By preventing asset managers from disaggregating independent account controllers for purposes of position limits, asset managers and/or independent account controllers to whom they allocate assets may be compelled to reduce their participation in the futures markets, and/or shift their business to other venues, resulting in a reduction of market liquidity on U.S. futures exchanges. We also note that the Proposed Rules would effectively require otherwise independent trading operations of commonly owned enterprises to communicate with each other as to their trading positions and intentions so as to avoid violating position limits. A trader, such as a pension plan, also would be required to signal to its independent managers the positions of its other independent managers to ensure that the trader does not exceed the position limits. Such communications would raise confidentiality issues and the potential for trading in concert, which is precisely the sort of behavior that the Proposed Rules seek to avoid.

In proposing this new exemption, the Commission acknowledges the comments to the January 2010 Notice that the removal of the independent account controller exemption would force aggregation in situations where meaningful control, management, and information barriers demonstrated sufficient independence to warrant disaggregation. The Commission states that the Proposed Rules “address the concern of not having an independent account controller exemption by establishing the owned non-financial entity exemption.”<sup>40</sup> While MFA appreciates the Commission’s attempt to alleviate this concern, we believe that this proposed non-financial entity exemption is too narrow to provide meaningful relief for market participants.

MFA believes that asset managers and corporate enterprises should be free to allocate capital efficiently across all types of business lines (including speculative trading ventures and commercial enterprises - both financial and non-financial) and independent managers without fear that this independent trading will be subject to aggregated position limits, possibly affecting their ability to participate in a given market.

MFA also believes that the current disaggregation rules generally have been successful in preventing a single trader that has control over multiple accounts from establishing positions in excess of position limits, while at the same time affording investors the opportunity to gain exposure to diverse trading strategies employed by various independent managers without the fear of being deemed to be trading in concert with such managers. In instances where the Commission has found that a trader violated position limits because its positions should have been aggregated, the Commission has been able to address aggregation in the enforcement action.<sup>41</sup> A fair, effective and rigorous enforcement program will discourage future violations.

Furthermore, the Commission has not provided any explanation of its rationale for treating financial entities differently from non-financial entities. A financial entity should be able to qualify for this exclusion if it operates with enumerated separation of functions and risk management procedures. If the Commission is concerned that the information barriers constructed between commonly owned enterprises are inadequate for the purposes of maintaining true independence among account controllers, the appropriate regulatory response would be to audit for the adequacy of, and compliance with, such

---

<sup>39</sup> Statement of Aggregation Policy and Adoption of Related Reporting Rules, 44 Fed. Reg. 33839 (June 13, 1979) (the “Aggregation Policy”).

<sup>40</sup> 76 Fed. Reg. at 4756.

<sup>41</sup> See, e.g., *In re Andrew W. Daniels*, CFTC Docket No. 11-05 (Jan. 26, 2011) and *In re Dairy Farmers of America, Inc.*, CFTC Docket No. 09-02 (Dec. 15, 2008).



information barrier policies and procedures, and then take action to correct any deficiencies found, rather than to automatically require aggregation.

*The Commission should not curtail the pool participant exemption.*

Under Commission Rule 150.4(b), a trader who is a limited partner or shareholder in a commodity pool (other than the pool's CPO) with an ownership or equity interest of 10% or more in the pool generally need not aggregate the pool's positions so long as such trader does not control the trading of such pool. Moreover, under Commission Regulation 150.4(c)(2) if the trader who is a limited partner or shareholder with an equity or ownership interest of 10% or greater in the pool is an affiliate of the pool's CPO, the trader need not aggregate the pool's positions, provided that: (i) the pool's CPO maintains written procedures to preclude the trader from having knowledge of, or gaining access to, the pool's trading or positions; (ii) the trader does not have direct, day-to-day supervisory authority or control over the pool's trading decisions; and (iii) if the trader is a principal of the pool's CPO, the trader maintains only such minimum control consistent with its responsibilities as a principal and its duty to supervise the pool's trading activities.<sup>42</sup>

Under Proposed Rule 151.7, the position limits in referenced contracts would apply to all positions in accounts in which any trader, directly or indirectly, has an ownership or equity interest of 10 percent or greater or, by power of attorney or otherwise, controls trading. Proposed Rule 151.7 contains a limited exemption for positions in pools in which a participating person has an ownership interest of between 10% and 25%, if the person does not have control over or knowledge of the pool's trading. Under the Proposed Rules, there is no possibility for disaggregation if ownership reaches 25%, whereas under the current rules, this would apply only if the pool operator was exempt from registration under Commission Rule 4.13 and relief under the independent account controller exemption for nonspot month positions is not applicable.

One of the Commission's goals in implementing position limits is the prevention of concentration of large positions in one or a few traders' accounts, which may create the unwarranted appearance of liquidity and market depth, which, in fact, may not exist.<sup>43</sup> The Commission states that "[p]osition limits address these risks through ensuring the participation of a minimum number of traders that are independent of each other and have different trading objectives and strategies."<sup>44</sup> By aggregating independent traders, rather than allowing them to trade independently, the Commission is increasing concentration that will result in more limited investment opportunities, burden investors and investment managers, and potentially reduce liquidity in U.S. futures markets.

The monitoring of ownership percentages of investors in a commodity pool is burdensome, difficult to manage, and creates a potential trap for investors who may unintentionally violate limits. Many commodity pools offer investors the opportunity to contribute capital and make withdrawals on a quarterly or monthly basis, and in some instances, more frequently. Withdrawals from a commodity pool generally require advance notice. An investor would need to constantly monitor its ownership percentage in the commodity pool to determine whether or not aggregation was required. For example, if a pension plan investor in a commodity pool has a 20% percentage interest in the commodity pool, and another

---

<sup>42</sup> Additionally, Commission staff has provided no-action relief from having to aggregate positions on the basis of taking a 10% or greater ownership or equity interest in another entity on a case-by-case basis, where, among other things, trading is conducted separately and independently by or on behalf of the two affiliated entities.

<sup>43</sup> 76 Fed. Reg. at 4755.

<sup>44</sup> 76 Fed. Reg. at 4755.

investor makes a substantial withdrawal, such that the pension plan's percentage interest increases to 30%, it will need to aggregate the commodity pool's positions, without the possibility of an exemption. It may request a withdrawal from the commodity pool, but would be required to aggregate its positions until the withdrawal became effective. As a result, the pension plan, who has no investment discretion and whose investment in the commodity pool has not changed, could unwittingly violate position limits due to the required aggregation. The effect would be to severely limit the pension plan's ability to diversify its allocations and meet its plan obligations. This also could limit the ability of pool operators to launch new commodity pools, as pool operators will need to attract more seed investors to alleviate concerns that any initial investor will exceed 25% ownership.

By the same token, an investor in a pool that is required to monitor and aggregate its positions with a commodity pool typically will not be able to obtain the commodity pool's position information on a real-time basis. Also, since such an investor has no investment discretion, it will not be able to cause the commodity pool to reduce its positions to cause the investor to be in compliance with the position limits. For example, an investor, such as a university endowment, that owns a 30% interest in each of two commodity pools, with no investment discretion in either pool, could be in violation of the position limits if the managers of each pool, on their own initiative, take large positions in a referenced contract. The investor likely will not know that its aggregate position violates the position limits and will have no ability to cause the commodity pools to reduce their respective positions. Even if the investor did become aware of the large positions, the investor may not be able to redeem its interest in the commodity pool due to the commodity pool's liquidity provisions. Assuming that the investor was aware of the large positions, and was able to redeem its interests, MFA believes that a passive investor in a commodity pool should be permitted to retain its interests because the trader's ability to harm or manipulate the market is limited by its lack of investment control.

*An application, approval and annual renewal based exemption to the aggregation requirements is unnecessary and inconsistent with the normal operation of traders.*

The change from a self-executing disaggregation exemption to an application and approval-based exemption, with an annual renewal application and approval, from the aggregation requirements creates an additional burden on traders and the Commission without any tangible benefit. The application rules would require a trader to file an application to be exempt from the disaggregation requirements no later than 9:00 am on the business day following the reporting obligation.<sup>45</sup> The Commission estimates that the proposed reporting requirements would affect 60 entities and result in a total burden of 300,000 labor hours. This results in an estimate of an astonishing 5,000 labor hours per filing.<sup>46</sup> In the event a trader determined it had exceeded the position limits but was entitled to disaggregate its positions, it would simply be impossible for a trader to prepare and complete the filing before 9:00 am on the next business day. Further, as described above, because of a lack of position visibility or account control, many passive traders may not know that they had violated the position limits until after the filing deadline. This may lead to many prudent traders filing anticipatory exemption applications and annual renewals, regardless of whether they will ever need to rely on the exemptions.

---

<sup>45</sup> MFA notes that the timing of the filing requirement is not clear from the proposed rules; however, for purposes of this comment letter, MFA is assuming that the Commission intended §151.10(b) to apply to the filing of an exemption.

<sup>46</sup> 76 Fed. Reg. at 4766. MFA believes that this may be a typographical error; however, its comments remain relevant even if the correct estimate of the reporting burden is significantly less.

The Commission states that “the self-executing nature of the exemptions creates an insufficient and inefficient verification regime and ultimately diminishes the Commission’s ability to properly perform its market surveillance responsibilities.” MFA believes that the Commission has historically done an excellent job of performing its market surveillance responsibilities under the existing rules. The Commission does not describe why the current system is insufficient and inefficient, and cites no evidence of abuse of the existing self-executing exemptive procedure. Nor does the Commission cite to any instances where additional information about account controllers would have enabled it to act more expeditiously or effectively in fulfilling its market surveillance responsibilities. Nor does the Commission explain why an annual renewal of this exemption would enhance the Commission’s ability to perform market surveillance.

As we describe below, the answer is not for Commission staff to spend its limited resources reviewing exemption applications and annual renewals, but rather, the Commission should dedicate those valuable resources to surveillance, audit and enforcement as it has successfully done to date. Instead of requiring an application for exemptive relief and annual renewals, the Commission could require independent account controllers to file a notice informing the Commission that they are availing themselves of the exemption and a representation that they meet the relevant standards. The Commission should require that this notice be filed on an annual basis and remain effective until withdrawn by the trader. Then through its surveillance function, the Commission could audit any entities or account controllers whose activity raises a specific aggregation concern.

If, for example, the Commission is concerned that the information barriers between commonly owned enterprises are inadequate, an appropriate regulatory response would be to audit for the adequacy of, and compliance with, such information barrier policies and procedures, rather than to automatically require aggregation with no opportunity for relief. The Commission already has access to information regarding cross-ownership of traders through its Statement of Reporting Trader forms and may use this information to cross-reference trade information to determine if an examination of the account controller’s independence is warranted.

### C. SPOT-MONTH LIMITS ON CASH-SETTLED CONTRACTS

*Although limits on spot-month levels at 25% of deliverable supply is an historical level for physically-delivered contracts, the Commission does not justify its application of this level to cash-settled contracts. Additionally, the Commission does not explain its constraint of calculating deliverable supply to a given delivery point. Furthermore, the Commission does not provide any quantitative or economic analysis as to why the conditional limit for cash-settled contracts should only be five times the spot-month limit.*

While MFA agrees that deliverable supply is an appropriate basis for setting limits on physically-settled contracts, which involve the making and taking of delivery and impact a commodity’s settlement price, we do not believe that the same is true for cash-settled contracts. Imposing equal levels for each contract type presupposes they are fungible contracts, which they are not, and may result in unnecessarily constraining legitimate risk management activity with the cash-settled contract in the spot month. We would urge the Commission to consider alternative approaches, including applying the aggregate limit to cash-settled contracts instead.

Even if the Commission determines that a limit for cash-settled contracts based off of deliverable supply is necessary, tying the overall calculation to a given delivery point in all cases is misguided. Certain benchmark contracts, such as the NYMEX Henry Hub Natural Gas contract, are widely used by a range of commercial hedgers to manage their risks. In many instances, the hedger has no intention of

making or taking delivery at the Henry Hub, but rather uses the cash-settled contract for its superior liquidity and price discovery to hedge risks in other locations or for other commodities with significant natural gas inputs. By limiting the calculation of deliverable supply only to this one point in Erath, Louisiana, however, the Commission would be ignoring this sizeable activity and arrive at a number far too low to accommodate it. These dynamics may vary by asset class, commodity, and contract type, and the Commission should give due consideration to these factors in devising its limits methodology rather than taking a one-size fits all approach.

Finally, and in related fashion, the conditional cash-settled limit of five times the spot month limit for those not holding any physically-settled contracts appears to be arbitrary and likely insufficient. The Commission provides no indication as to how it arrived at this figure or that it strikes the right balance between supporting liquidity and diminishing undue burdens. We note that since the CME adopted similar rules for its NYMEX cash-settled natural gas futures contract in February 2010, early analysis has shown that the closing range on the last day of trading of the physically-delivered contract has widened, which suggests that the new rule has resulted in greater price volatility on the last day of trading. Taken into consideration with the potentially low deliverable supply calculation described above, the conditional limit could have an even less cushioning effect for contracts and markets that historically have seen greater activity during this period. As before, we respectfully suggest that the Commission consider the dynamics of individual spot month markets before making a limit determination and ensure that the calculations are responsive and not overly rigid. While five times may suffice for certain commodities, it may be insufficient and disruptive in others.

#### **D. INTER-COMMODITY SPREAD EXEMPTION**

*The Commission should include an inter-commodity spread and arbitrage exemption, which currently appears in exchange rules, to allow for legitimate trading practices that promote risk reduction.*

The Commission should use its statutory authority in Section 4a(a)(7) to permit an exemption for inter-commodity spread and arbitrage transactions. Pursuant to existing rule 150.5, exchange rules currently contemplate the availability of an exemption for inter-commodity spread and arbitrage transactions,<sup>47</sup> but no analogous exemption has been included in the Proposed Rules. The Commission should provide for an exemption for intercommodity spreads, which reflect a relationship between two commodities rather than an outright directional position in the spread components. For example, a market participant may purchase electricity from a producer while simultaneously selling natural gas. The participant is expressing a view as to the relative value of each commodity (given their fixed relationship – natural gas is used in the generation of electricity) while hedging its overall risk and providing liquidity to both markets. Exemptions have historically recognized the flattening out of this risk by counting only the net amount toward one's position size. Arbitrage and inter-commodity spreads do not raise the same price volatility concerns as outright positions. On the contrary, they constitute a standard investment practice that minimizes exposure while capturing inefficiencies in an established relationship and aiding price discovery in each contract. Eliminating inter-commodity exemptions will inhibit such efficiency, particularly given the lack of single contracts that perform the same function.

---

<sup>47</sup> See Chicago Mercantile Exchange Rule 559.C.

## **E. ADDITIONAL CONCERNS AND SUGGESTIONS**

### ***1. The Commission's proposed class limits rules in the non-spot months impose costly administrative and compliance burdens.***

The proposed class limits would apply across classes (e.g., futures class and swaps class) and would apply single-month and all-months combined to each class individually. The Commission's rationale for class limits is to ensure market power is not concentrated in any submarket and that a trader is not holding excessively large, but offsetting positions in any one submarket. However, separate class limits are inconsistent with the Commission's premise underlying aggregate limits, i.e., that swap and futures markets are essentially a single market. The perceived benefits from the class limits rules could be achieved in a less burdensome manner, for example, through market surveillance of large trader data. Additionally, the Commission has conceded that it requires additional, reliable, and verifiable data to enforce the non-spot month limits.<sup>48</sup> The Commission should wait until it has collected and evaluated data regarding open interest in the futures and swap markets before determining whether class limits provide any additional benefit. It is premature for the Commission to establish a class limit framework in the absence of objective, quantitative market data.

### ***2. Limits based on an annual calculation of estimated deliverable supply may not adequately take into account seasonal fluctuations or trends in volume.***

The Proposed Rules would require each DCM that lists a referenced contract to submit to the Commission an estimate of deliverable supply on an annual basis. The Commission would consider the DCM's estimate in conjunction with analyzing its own data to make a final determination of deliverable supply. MFA is concerned that this approach may not take into account seasonal fluctuation that may exist in some of the referenced commodities, resulting in periods where the position limits are too low to permit effective risk management. MFA also is concerned that resetting limits only on an annual basis may not adequately address spikes in demand or deliverable supply that may occur during the course of the year. MFA urges the Commission to consider whether the annual re-calculation of annual limits should be based upon the peak seasonal deliverable supply in the prior year, or whether it would be appropriate, with respect to certain referenced contracts, to provide for adjustments to limits more frequently than just once a year. Because different commodities have different seasonality and react to different market fundamentals, a single approach may not work for all types of referenced contracts, and the Commission may wish to consider a more flexible approach.

### ***3. There should be no legacy position limits for agricultural contracts, rather such contracts should be subject to the same limits as other commodities under the Proposed Rules.***

In the Proposed Rules, the Commission determined that extending Commission-set position limits beyond agricultural products to metals and energy commodities would create a "uniform approach would also encourage better risk management and could reduce systemic risk."<sup>49</sup> However, by proposing legacy limits that would retain current all-months combined limits for certain agricultural contracts, the Commission has not adopted a uniform approach.<sup>50</sup> Moreover, since these limits were originally set in 2004, at a time when open interest levels were much smaller, they do not reflect current market activity

---

<sup>48</sup> 76 Fed. Reg. at 4759.

<sup>49</sup> 76 Fed. Reg. at 4755.

<sup>50</sup> CBOT: Corn and Mini-Corn, Oats, Soybeans and Mini-Soybeans, Wheat and Mini-Wheat, Soybean Oil, Soybean Meal; MGE: Hard Red Spring Wheat; NYBOT (ICE): Cotton No. 2; KCBOT: Hard Winter Wheat.



and should be updated. Indeed, if they were adjusted to reflect today's size, wheat limits would rise by 144% and corn by 108%.<sup>51</sup> For this reason and for the sake of efficiency, if the Commission ultimately decides to impose limits across all 28 commodities, MFA believes that legacy levels should be abandoned in favor of the new levels.

***4. The proposed pre-existing position exemption may have unintended harmful consequences.***

The Proposed Rules provide a limited exception for positions in futures or options contracts on a derivatives contract market that are in excess of the position limits at the time they are implemented. Traders would not be permitted to enter into new contracts in the same direction, but could enter into offsetting positions. MFA has concerns about the implementation of this exemption. For example, an index fund manager who has established and carries a pre-existing position in excess of the proposed new limits and desires to roll its positions into a subsequent month will have to trade naked out of that portion of its position that exceeds the new limits. Since the index fund positions (and often, the timing of the roll) generally are known to the market, other traders may take undue advantage of the index fund when it rolls its positions, and/or the liquidation of the excess position could be disruptive to the market. If the Commission moves forward with the proposed limits, it should permit a six-month phase-out period for pre-existing positions and allow managers to roll pre-existing positions into the next month, despite the fact that they may exceed the new position limits.

***5. The Commission should clarify its intentions for rulemaking relating to limits for significant price discovery contracts.***

MFA requests that the Commission clarify its intentions with respect to its proposal to issue a separate rulemaking for limits relating to significant price discovery contracts that are linked to the referenced contracts.<sup>52</sup> MFA would like to understand how such limits may interact with the aggregate and class limits set forth in this Proposed Rulemaking. For example, does the Commission intend to include significant price discovery contracts in the class limits? MFA believes that a better understanding of how such limits may interact is critical to providing complete and meaningful feedback on the Proposed Rules.

***6. The Commission should clarify the use of rounding in determining limits - no rounding should apply to trader's positions.***

Section 151.4(g) states that “[i]n determining or calculating all levels and limits under this section, a resulting number shall be rounded up to the nearest hundred contracts.” The Commission should clarify that the use of rounding applies to the calculation methodology used by the Commission to compute position limits levels, and not to the computation of positions held by traders. In other words, the rounding rule should not result in a trader that holds 501 contracts being deemed to hold 600 contracts for the purpose of complying with the position limits.

---

<sup>51</sup> See Roberta Rampton, *Analysis: Crunch time for U.S. commodity speculation crack-down*, Reuters, March 23, 2011, available at: <http://www.reuters.com/article/2011/03/23/us-financial-regulation-limits-idUSTRE72M13E20110323>

<sup>52</sup> 76 Fed. Reg. at 4753, n. 8.

**7. *The Commission should provide guidance as to the application of the Proposed Rule by illustrating the application of the rules to a hypothetical portfolio.***

MFA believes that certain aspects of the proposed position limit rules may be subject to differing interpretations and/or uncertainty in application, and believes that a worked-example illustrating the application of the proposed position limit rules would be useful. To that end, MFA is attaching as Exhibit A, a series of hypothetical portfolios of speculative positions in Henry Hub natural gas that is designed to assist MFA members and other market participants in better understanding: (i) netting and aggregation of instruments within an exchange, across exchanges, and across instrument types; (ii) treatment of physical vs. financial contracts; (iii) treatment of cleared vs. non-cleared bilateral contracts; (iv) limits for front month vs. deferred month positions; (v) calculation of open interest; and (vi) treatment of classes of contracts (futures + options, swaps). For each portfolio, MFA believes that it would be useful for the Commission to specify: (a) the set of limits applicable to the position; (b) how the position is allocated to each applicable limit; (c) the formula for determining each limit; and (d) the outcome of the allocation of each limit to the portion of each position to which it applies.

#### **IV. CONCLUSION**

Our domestic regulated futures markets play a leading role in price discovery and risk transference in the U.S. and globally. We share the Commission's desire to preserve and enhance the integrity of our markets. However, we believe the Commission has not struck the appropriate balance between diminishing speculation and preventing market manipulation, and ensuring sufficient market liquidity for bona fide hedgers and ensuring that the price discovery function of the underlying market is not disrupted. The Commission has not fully addressed the costs to the markets and their participants of the proposed federal limits, particularly the potential for reduced liquidity and a corresponding decline in the competitiveness of U.S. futures markets as business migrates overseas.<sup>53</sup> MFA agrees with the sentiment of Commissioner Sommers that driving business overseas is a concern that remains unaddressed by the Proposed Rules.<sup>54</sup>

While MFA acknowledges that the Commission is following a congressional mandate to propose and adopt rules establishing position limits, MFA respectfully suggests it consider the full weight of the statutory qualification "as needed" and only make such modifications to the current position limit framework as are absolutely necessary. In several instances, the Commission has proposed seemingly slight modifications to existing rules that in fact will have a huge impact on participants and the markets. MFA suggests that in instances where the current rules have proven to operate properly, such as the existing aggregation rules and disaggregation exemptions, and the bona fide hedge exemption, the Commission should leave them unchanged.

---

<sup>53</sup> MFA notes that Section 719 of the Dodd-Frank Act requires the Commission, in consultation with DCMs, to conduct a study on the effects (if any) of the position limits on excessive speculation and on the movement of transactions from exchanges in the U.S. to trading volumes outside the U.S.

<sup>54</sup> Opening Statement of Commissioner Jill E. Sommers, Commodity Futures Trading Commission Open Meeting (January 13, 2011) ("Section 737 of Dodd-Frank states that the Commission shall strive to ensure that position limits will not cause price discovery in the commodity to shift to trading on foreign boards of trade. This 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.")

Mr. Stawick  
March 28, 2011  
Page **21** of **23**

We would be happy to discuss our comments or any of the issues raised by the Proposed Rules at greater length with the Commission or its staff. If staff has any questions, please do not hesitate to call Stuart J. Kaswell or the undersigned at (202) 730-2600.

Respectfully submitted,

/s/ Richard H. Baker

Richard H. Baker  
President and CEO

cc:

Chairman Gary Gensler  
Commissioner Michael Dunn  
Commissioner Bart Chilton  
Commissioner Jill Sommers  
Commissioner Scott O'Malia  
Stephen Sherrod, Acting Deputy Director, Market Surveillance, Division of Market Oversight  
Bruce Fekrat, Senior Special Counsel, Office of the Director, Division of Market Oversight

Exhibit A

The following tables illustrate a series of hypothetical portfolios of speculative positions in Henry Hub Natural Gas contracts.

**FOR SPOT MONTH LIMITS**

|                                      | <b><u>HH Natural Gas</u></b><br><b><u>(All positions are speculative front-month)</u></b> |  |  |  |  |  |
|--------------------------------------|---|--|--|--|--|--|
|                                      | <b><u>Portfolio</u></b><br><b><u>1</u></b>  | <b><u>Portfolio</u></b><br><b><u>2</u></b> | <b><u>Portfolio</u></b><br><b><u>3</u></b> | <b><u>Portfolio</u></b><br><b><u>4</u></b> | <b><u>Portfolio</u></b><br><b><u>5</u></b> | <b><u>Portfolio</u></b><br><b><u>6</u></b> |
| <b><u>ICE CLEARED:</u></b>           |   |  |  |  |  |  |
| Last Day Swaps                       | 500   | 500  | 500  | 500  | 1500                                       | 1500                                       |
| Penultimate Swaps                    | 500   | 500  | 500  | 500  | -1400                                      | -1400                                      |
| Options (delta)                      | 500   | 500  | 500  | 500  | 500  | 500  |
| <b><u>NYMEX CLEARED:</u></b>         |   |  |  |  |  |  |
| Last Day Swaps                       | 500   | 500  | 500  | 500  | -1700                                      | -1700                                      |
| Penultimate Swaps                    | 500   | 500  | 500  | 500  | 1400                                       | 1400                                       |
| Financial Options (delta)            | 500   | 500  | 500  | 500  | -500                                       | -500                                       |
| Financial Cal Spread Options (delta) | 0   | 0  | 0  | 0  | -500                                       | -500                                       |
| Physical Cal Spread Options (delta)  | 0   | 0  | 0  | 0  | 250  | 250  |
| Physical Options (delta)             | 0   | 250  | 0  | 0  | -500                                       | -500                                       |
| Futures                              | 250   | 0  | 0  | 0  | 250  | 250  |
| <b><u>BILATERAL:</u></b>             |   |  |  |  |  |  |
| Swaps                                | 0   | 0  | 0  | 3000                                       | 0  | -700                                       |

**FOR NON-SPOT-MONTH LIMITS**

|                                      | <b>Jan-2012 HH Natural Gas</b><br><b>(All positions are speculative)</b> |   |   |   |   |   |   |  |
|--------------------------------------|--|---|---|---|---|---|---|--|
|                                      | <b><u>Portfoli</u></b><br><b><u>1</u></b>                                | <b><u>Portfoli</u></b><br><b><u>2</u></b> | <b><u>Portfoli</u></b><br><b><u>3</u></b> | <b><u>Portfoli</u></b><br><b><u>4</u></b> | <b><u>Portfoli</u></b><br><b><u>5</u></b> | <b><u>Portfoli</u></b><br><b><u>6</u></b> | <b><u>Portfoli</u></b><br><b><u>7</u></b> | <b><u>Portfolio</u></b><br><b><u>8</u></b> |
| <b><u>ICE CLEARED:</u></b>           |  |   |   |   |   |   |   |  |
| Last Day Swaps                       | 3800   | 3800                                      | 3800                                      | 0   | 0   | 3800                                      | 3000                                      | -3000                                      |
| Penultimate Swaps                    | 500  | 500                                       | 500                                       | 0   | 0   | 500                                       | -2800                                     | 3800                                       |
| Options (delta)                      | 500  | 500                                       | 0   | 0   | 0   | 500                                       | 1000                                      | -2000                                      |
| <b><u>NYMEX CLEARED:</u></b>         |  |   |   |   |   |   |   |  |
| Last Day Swaps                       | 3800   | 0   | 0   | 3800                                      | 3800                                      | 3800                                      | -3400                                     | -3400                                      |
| Penultimate Swaps                    | 500  | 0   | 0   | 500                                       | 900                                       | 900                                       | 2800                                      | 3800                                       |
| Financial Options (delta)            | 500  | 0   | 0   | 500                                       | 0   | 0   | -1000                                     | -1000                                      |
| Financial Cal Spread Options (delta) | 0  | 0   | 0   | 0   | 0   | 0   | -1000                                     | -2000                                      |
| Physical Cal Spread Options (delta)  | 0  | 0   | 0   | 0   | 0   | 0   | 500                                       | 500  |
| Physical Options (delta)             | 0  | 0   | 0   | 500                                       | 500                                       | 500                                       | -1000                                     | -2000                                      |
| Futures                              | 0  | 0   | 0   | 3800                                      | 3800                                      | 3800                                      | 500                                       | -2000                                      |
| <b><u>BILATERAL:</u></b>             |  |   |   |   |   |   |   |  |
| Swaps                                | 0  | 0   | 0   | 0   | 0   | 15000                                     | 0   | -4000                                      |