BLACKROCK

March 28, 2011

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

Re: Position Limits for Derivatives 17 CFR Parts 1, 150 and 151 (RIN 3038-AD15 and 3038-AD16)

Dear Mr. Stawick:

BlackRock, Inc. submits these comments on the Commodity Futures Trading Commission's (the "CFTC" or "Commission") Notice of Proposed Rulemaking entitled "Position Limits for Derivatives" (the "Proposed Rules").[1] In the Proposed Rules, the Commission proposes to establish position limits and limit formulas for certain physical commodity futures and option contracts executed pursuant to the rules of designated contract markets ("DCMs") and physical commodity swaps that are economically equivalent to such DCM contracts.

BlackRock is one of the world's leading asset management firms. We manage over $3.54 trillion on behalf of institutional and individual clients worldwide through a variety of equity, fixed income, cash management, alternative investment, real estate and advisory products. Our client base includes corporate, public and multi-employer pension plans, insurance companies, third-party mutual funds, endowments, foundations, charities, corporations, official institutions, banks, and individuals around the world.

Many of our clients, particularly institutional investors, seek investments in asset classes that are uncorrelated with traditional portfolio asset classes (i.e. equity and fixed income) in order to achieve portfolio diversification, to manage the volatility risk to which investment portfolios are subject, and to improve risk-adjusted returns. Investment research indicates that appropriately structured indices and baskets of physical commodities exhibit investment return characteristics that are uncorrelated with traditional equity and fixed income assets. Through economies of scale, BlackRock is able to offer such exposure to the commodity markets to these institutional investors at a competitive cost with best-in-class risk management. Notably, BlackRock does not engage in proprietary trading whether in commodities, commodity derivatives, or any other asset class. As a fiduciary for our clients, we have a strong interest in a regulatory regime that supports fair, competitive, and orderly markets.

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1 *See* 76 Fed. Reg. 4752 (Jan. 26, 2011).

BlackRock's principal objections to the Commission's proposal are two-fold. First, we are concerned overall that the proposal will reduce market liquidity by limiting the capacity of many market participants, including dealers, to enter into transactions in commodities subject to CFTC limits. This reduction in essential market liquidity will harm the public interests in price discovery and efficient risk management, resulting in increased costs to market participants (including hedgers) and decreased investment returns for investors in our funds, beneficiaries of pension plans, and other market participants we serve. Second, we are also concerned that the proposed aggregation standards – including repeal of the current independent account controller regime – would impose irrational restrictions and excessive administrative compliance burdens on many of BlackRock's operations and clients without adding any protection against the harms position limits are intended to address. BlackRock strongly urges the Commission to reconsider that aspect of its proposal.

Overview

The Commodity Exchange Act ("CEA") recognizes that speculation is critical to the success of derivatives markets. In particular, Section 3(a) of the CEA acknowledges that speculators serve the "national public interest" by "assuming price risks, discovering prices, or disseminating pricing information" through trading in "liquid, fair and financially secure trading facilities." While some confuse speculation with manipulation, the two could not be more different. As every Commissioner has acknowledged, speculation is essential for liquid trading markets; price manipulation is a criminal act.

Although speculation is essential, Congress has empowered the Commission to limit large speculative positions when necessary and appropriate to prevent price manipulation and extreme volatility. As others have pointed out, the Commission's proposal does not meet this legal standard and is not supported by any peer-reviewed, credible empirical study as a means to thwart excessively high or low commodity prices. In these circumstances, BlackRock questions whether the imposition of the proposed position limits will serve the interests of the public, the markets and our clients.

Make no mistake, BlackRock fully supports the Commission's efforts to prevent price manipulation and other illegitimate price distortions. In our view, however, the proposed speculative position limit regime will do much harm and little good. The Commission's stated justification for the Proposed Rules does not demonstrate how the costs the Proposed Rules would inflict on markets and market participants are outweighed by any benefits. BlackRock therefore recommends that, as a first step, the Commission should enhance its oversight and market surveillance capabilities before imposing hard, federal position limits. To this end, the Commission's proposed position visibility regulations could, if modified to apply only in market circumstances where additional data was actually needed, serve as market-wide federal accountability rules, and BlackRock would support their adoption for this purpose.

Our comments will first touch briefly on whether the Commission has satisfied its burden of proof for imposing position limits. We then devote the bulk of our comments to the Commission's proposed changes to its longstanding Part 150 aggregation framework and the

impact of these changes on the market in general and on large, global asset managers such as BlackRock in particular. We will also discuss the role of passive commodity index investors in the commodity futures markets and highlight how the Proposed Rules would affect commodity index strategies and trading in the referenced contracts. Finally, we offer some brief comments on other aspects of the proposed position limit regime (i.e. restrictive exemptions, class limits, annual recalculation of limits based on open interest, and position visibility levels).

I. The Commission Has Not Satisfied Its Burden of Proof.

BlackRock agrees with other commenters that the Commission must find that any position limits it would propose are "necessary" to prevent the burdens of excessive speculation and "appropriate" to balance four congressional market objectives under Section 4a(a) of the CEA. The Commission's proposal does not contain the required rationale; this omission alone is reason for reconsideration.

The Commission does not support its proposal by citing any modern economic study proving that large speculative positions cause artificial prices or price volatility. To the contrary, economists, academics, international agencies, and U.S. governmental entities, including the Commission itself, have not identified a causal link between speculation – whether by index funds specifically or speculators generally – and price volatility in commodities.[2] For example, the Organisation of Economic Cooperation and Development ("OECD") recently released an empirical study which determined that there is no statistically significant relationship indicating that changes in index and swap fund positions have increased market volatility. *See* S.H. Irwin & D.R. Sanders, "The Impact of Index and Swap Funds on Commodity Futures Markets: Preliminary Results," *OECD Food, Agriculture and Fisheries Working Papers*, No. 27, OECD Publishing (2010) ("2010 OECD Report"). The OECD study further concluded that those reports suggesting that speculation creates price bubbles in commodities were not based on credible evidence.

[2] *See, e.g.*, Barclays Capital, Commodities Research Report (Feb. 24, 2011) (observing that there is no empirical evidence of links between high prices and speculation and that new data suggests index investors add to price stability); Paul Krugman, *The Finite World*, N.Y. Times, Dec. 26, 2010, http://www.nytimes.com/2010/12/27/opinion/27krugman.html (stating that the recent surges in commodity prices "mainly reflect fundamental factors" and are not the result of "speculation run amok"); U.S. Government Accountability Office, Issues Involving the Use of the Futures Markets to Invest in Commodity Indexes at 5 (Jan. 30, 2009), http://www.gao.gov/new.items/d09285r.pdf (concluding that the eight empirical studies reviewed "generally found limited statistical evidence of a causal relationship between speculation in the futures markets and changes in commodity prices" regardless of whether the studies focused on index traders or speculators in general); CFTC, Staff Report on Commodity Swap Dealers & Index Traders at 27-30 (Sept. 2008), http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/cftcstaffreportonswapdealers09.pdf (finding no causal relationship between commodity index fund activity and sudden price movements in certain agricultural commodities); CME Group, Excessive Speculation and Position Limits in Energy Derivatives Markets, http://cmegroup.com/company/files/PositionLimitsWhitePaper.pdf (noting that "[n]early all economists that have carefully studied [commodity] markets have concluded that supply and demand fundamentals and other macroeconomic factors were the cause of these price movements).

Rather than link commodity price movements to speculation, reputable studies have uniformly found that fundamental market conditions are the driving force behind such price fluctuations. Even the Commission's research shows that the rise in oil prices in 2008 was largely attributable to supply and demand factors, and recognizes that speculation plays a vital role in providing liquidity and dampening price volatility in the commodity markets.[3] CFTC Commissioner Michael Dunn echoed these findings at a recent public meeting, stating: "[P]rice volatility exists in our markets because we live in a 'finite world' where there is not, at any given moment in time, an inexhaustible supply of oil, wheat, milk or other physical commodities to meet the global demand for such products." *See* Commissioner Michael V. Dunn, Opening Statement, Open Meeting on Ninth Series of Proposed Rulemakings Under the Dodd-Frank Act (Jan. 13, 2011) ("Dunn Opening Statement"), http://www.cftc.gov/PressRoom/SpeechesTestimony/dunnstatement011311.html.

All of the above sources illustrate the difficulty the Commission will have in meeting its burden of proof before adopting any final position limit rules. As Commissioner Dunn observed, position limits at best would be "a cure for a disease that does not exist or at worst, a placebo for one that does." *Id.* BlackRock thus urges the Commission to reassess whether to pursue federal position limits consistent with the statute at this time.

II. The Proposed Departures from the Longstanding Part 150 Aggregation Framework Are Unwarranted and Will Have Serious, Negative Policy Consequences.

The Commission's policy for the aggregation of positions must be evaluated to determine whether it serves the statutory purpose of any position limit regime – i.e. to prevent unreasonable or unwarranted prices. Even if we were to accept that speculative trading at certain levels causes such prices – a contention that, as discussed above, finds no support in credible empirical studies to date – only those who control that speculative trading would be in a position to influence price. Account controllers, who are hired and authorized to make buy and sell decisions, have control over trading decisions that could affect price. Others who own accounts, invest in funds or organize funds do not. Aggregation should therefore be focused on account controllers.

The Commission's existing Part 150 aggregation framework codifies this logic through a series of aggregation exemptions that result in aggregation at the "control" level – including exemptions in the pooled account context for passive pool participants and passive managers of pools, an independent account controller exemption for eligible entities,[4] and an exemption for futures commission merchants ("FCMs") and their affiliates. At their core, all of these exemptions recognize that a party should not be required to aggregate positions where it does not control the trading of those positions.

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[3] *See, e.g.*, InterAgency Task Force on Commodity Markets, Interim Report on Crude Oil at 3-4 (July 22, 2008), http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/itfinterimreportoncrudeoil0708.pdf.

[4] BlackRock is an "eligible entity" under Regulation 150.3.

With the exception of the FCM exemption, the Commission's proposed aggregation policy does not retain the Part 150 exemptions that recognize "control" as the touchstone for aggregation. The Commission's proposal instead includes narrower pool exemptions, replaces the independent account controller exemption with an "owned non-financial entity" exemption that disaggregates on the basis of independent control only in limited circumstances, and adds an "identical trading strategy" aggregation rule that has potentially broad application. In effect, the proposed aggregation policy would largely treat as account controllers many who do not control or affect trading decisions in any way. This aggregation approach is analogous to subjecting the passengers on a bus to a speed limit to prevent accidents on the road. Even though the bus passengers in no way control the speed of the bus, they would inexplicably be held liable for any violations of the speed limit caused by the bus driver.

Just as bus passengers should not be subject to a speed limit as they are quite literally along for the ride, because they exercise no authority over the one person who determines the bus' speed (i.e. the bus driver), investors (and even the holding companies of asset managers that establish funds) should not be forced to aggregate the positions of a fund or account that they do not control. Such positions are logically attributable only to the account controllers or "drivers" of trading decisions. The Commission's Proposed Rules, however, appear to contemplate the double-counting of positions. They would treat as a "trader" subject to the proposed limits *both* the investor in a fund that retains a trading advisor and that trading advisor for purposes of the *same* positions established by the advisor for the fund. BlackRock maintains that this double-counting is unnecessary and causes the Commission's purportedly high limit levels to be illusory.

The following sections highlight the Commission's proposed departures from the well-established Part 150 aggregation framework and discuss why those changes would not prevent unwarranted or unreasonable prices and would have unintended, adverse consequences. To avoid any ambiguity of how we believe the Commission's Proposed Rules would work, we have set out a series of examples to help illustrate our concerns as they relate to how market participants, including asset managers, investors, funds, funds of funds, and separate accounts, will have to aggregate their positions. Where the Commission's Proposed Rules were unclear, we have consulted informally with the Commission's staff to attempt to obtain a better understanding. Despite these efforts, if our discussion reflects a misreading of the Commission's intended application of its Proposed Rules, we would respectfully urge the Commission to clarify its intention by republishing its Proposed Rules with the appropriate clarification if it intends to proceed with this rulemaking.

A. *Changes in Aggregation Exemptions Applicable to Pool Context*

The Commission's proposal eliminates the blanket aggregation exemption for passive pool participants (with a 10% or greater ownership or equity interest in a pool) who are not also principals or affiliates of the pool's commodity pool operator ("CPO"). Under the Commission's proposal, *all* passive pool participants would be subject to the aggregation requirement by virtue of their 10% or greater ownership or equity interest unless they meet certain exemption criteria. These criteria include: i) an inability to acquire knowledge of the pool's positions or trading due to information barriers maintained by the CPO, *and* ii) a lack of control over the pool's trading

decisions. Thus, a purely passive pool participant to whom the CPO discloses information on the pool's open positions would not qualify for an exemption notwithstanding the participant's lack of any trading control.

BlackRock is concerned that the Commission's proposed rule would force aggregation in situations where trading control does not exist. Just like any other passive participant, a pool participant with knowledge of a pool's positions, but no control over trading, is not in a position to influence price. Requiring such a pool participant to aggregate the pooled positions would thus not serve the statutory purpose of preventing unreasonable prices. Moreover, the "information barrier" requirement is unworkable as a matter of law and practice. Investors in a fund regularly need and receive information about the trading of the fund (including the fund's position holdings) from the fund's manager in order to manage their risk to categories of exposure and to satisfy their duty of due diligence to be informed about their investments. Index fund investors, in particular, will know about an index fund's positions because such position information is made public. For their part, CPOs are required by existing Commission regulations to make certain disclosures to investors, including monthly or quarterly statements of account and disclosures regarding the past performance of the pool (e.g. the total assets traded pursuant to the trading program). *See* Regulation 4.24(u) & 4.25. Given this legal and investment practice context, the exemption, as written, will prove unduly difficult to satisfy to the point of being illusory. This narrow or practically non-existent exemption relief will also have unintended, negative consequences.

Hypothetical 1[5]

An example can help illustrate these concerns. Assume Asset Manager has two subsidiaries: Subsidiary A and Subsidiary B. Each subsidiary hires an independent third party as investment manager to manage trading for a certain fund: Subsidiary A hires Investment Manager A to manage Fund A; Subsidiary B hires Investment Manager B to manage Fund B. Investor 1 has an 11% ownership interest in each Fund. Investor 1 has a risk management practice whereby it will request that a fund's investment manager provide some level of transparency regarding the fund's positions. Investment Manager A and Investment Manager B provide such information to Investor 1 upon request. Investor 1 has no control over the Funds' trading decisions.

Under the Commission's proposed aggregation framework, Asset Manager would be required to aggregate the positions of Fund A and Fund B because it would be viewed as exercising a form of "control" by virtue of its status as the parent entity of subsidiaries that manage the funds through independent investment managers. Each independent Investment Manager would be required to aggregate the positions of its respective Fund with those of any other funds that it manages because it controls the trading of the Fund's positions. Investor 1 would be required to aggregate the positions of Fund A and Fund B because its ownership

[5] For a diagram of this example, see the appendix attached to this letter (Hypothetical 1).

interest is greater than 10% and it does not otherwise qualify for the passive pool participant exemption due to its ability to receive disclosure of information regarding the pool's positions.

Aggregation at all of these levels leads to an *unnecessary* multiple counting of positions given that Asset Manager's trading "control" is illusory and Investor 1 likewise does not "control" trading. Because Asset Manager and Investor 1 do not make buy and sell decisions for the funds, they do not influence price (as an account controller might) and therefore are not in a position to cause unreasonable or unwarranted prices.

Not only does aggregation at the Asset Manager and Investor levels fail to serve the statutory purpose, but it will also have unintended, negative consequences. Faced with a potentially broad aggregation policy and narrow disaggregation relief, asset managers and passive investors will seek to avoid the legal risk of inadvertently violating Commission-set limits by reducing their participation in CFTC-regulated markets and/or shifting their activities to other instruments or other venues. Some asset managers, for example, may close funds to new investors or even close down some strategies completely. Reduced participation, in turn, will result in reduced volume and liquidity in the CFTC-regulated markets, thereby hindering the markets' underlying price discovery function and efficient risk management by hedgers. Additionally, investors who seek to qualify for the passive pool participant aggregation exemption might refrain from asking for position information, which would weaken their risk management practices.

Even where a passive pool participant meets the exemption criteria (and therefore cannot obtain knowledge of nor has control over a pool's trading decisions), the Proposed Rules would make aggregation *mandatory* if the pool participant holds a 25% or greater ownership or equity interest in the pool. The current Part 150 regime, by contrast, only applies the 25% aggregation trigger to pool participants whose CPO is exempt from registration under Regulation 4.13. Even then, those pool participants can qualify for an independent account controller aggregation exemption because they are among the "eligible entities" for that exemption.

The proposed mandatory aggregation rule would force aggregation on the basis of mere ownership. This rule will not serve the statutory purpose of preventing unreasonable or unwarranted price changes because only account *controllers* are in a position to influence price through their trading decisions. Further, making aggregation *mandatory* – with no possibility of disaggregation relief – will make double or multiple counting of positions virtually inescapable and will create compliance issues where position information is difficult to obtain due to firewalls or other information barriers.

Hypothetical 2[6]

Consider this example of the mandatory aggregation rule's application and implications: Investment and Trading Advisor ("ITA") A controls the trading of Fund A. Fund A has 4

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[6] For a diagram of this example, see the appendix attached to this letter (Hypothetical 2).

investors (Investor 1, Investor 2, Investor 3, and Investor 4), each with a 25% ownership interest in Fund A. Fund A has a 25% ownership interest in Fund B but does not control Fund B's trading. ITA B controls the trading of Fund B and is independent (actually a competitor) of ITA A. Fund A and Fund B each hold net short 100 positions. The CFTC-prescribed position limit is 150 contracts.

The Commission's proposed aggregation framework is silent, and therefore ambiguous, as to whether pro rata aggregation is permitted. We understand this silence to mean that the Commission intends no pro rata aggregation. Therefore, under the Proposed Rules, Fund A's positions would consist not only of the positions that it holds (i.e. 100 net short positions), but also all of Fund B's positions (i.e. 100 net short positions) by virtue of Fund A's 25% ownership interest in Fund B. Fund A's aggregate of 200 net short positions, in turn, would be attributed to *each* Investor with no possibility of disaggregation because each Investor has an ownership interest of 25% in Fund A.[7] Each Investor in Fund A – in addition to the Fund itself – would therefore be found to exceed the position limit by 50 contracts. The number of positions attributed to each Investor would be even greater if Fund A's aggregate positions increased. For example, if Fund B took on a 25% ownership interest in Fund C (which held 100 net short positions), Fund B's new aggregate (200 net short positions) would be attributed to Fund A because of Fund A's 25% ownership interest in Fund B. Fund A would then have an aggregate of 300 net short positions and this total would be imputed to *each* Investor.

Again, attributing Fund A's aggregate positions to each Investor will have no impact on preventing aberrant price movements because purely passive investors do not make the trading decisions that affect price. Moreover, aggregation would be unworkable if Fund A had firewalls preventing the Investors from gaining knowledge of Fund A's positions and/or if Fund B had firewalls preventing Fund A from accessing its position information.

BlackRock encourages the Commission to retain the existing Part 150 aggregation rules and exemptions for the pooled account context for contracts subject to position limits. Because the existing standards require aggregation only on the basis of actual control over trading, they serve the statutory purpose of preventing unreasonable or unwarranted price changes and avoid the unintended, harmful consequences identified above. The Commission has not provided, and BlackRock is not aware of, any reason to depart from this effective, longstanding policy.

B. *Elimination of Independent Account Controller Aggregation Exemption and Creation of Owned Non-Financial Entity Aggregation Exemption*

Under both the existing Part 150 aggregation policy and the Commission's proposed aggregation policy, a trader is required to aggregate positions in accounts in which the trader controls trading or has a 10% or greater ownership or equity interest. For decades, however, the Part 150 framework has made available an "independent account controller" exemption from the

[7] Fund A's positions would also be attributed to Investment Manager A and the asset manager of the Fund (not pictured in the diagram for Hypothetical 2 in the appendix).

10% or more ownership aggregation standard. This exemption allows "eligible entities" (e.g. mutual funds, commodity pool operators, commodity trading advisors, insurance companies, banks or trust companies, and pool participants in pools where the CPO is exempt from registration under Regulation 4.13) to disaggregate positions that are carried for them in the separate accounts of independent account controllers. *See* Regulation 150.3(a)(4). Disaggregating commonly owned, but independently controlled accounts makes sense because such accounts are not trading in concert or otherwise acting like a single speculative trading entity that should be subject to one limit.

The Commission proposes to eliminate this longstanding exemption, but cites no problems or abuses in the commodity markets arising out of the use of the exemption. Rather, the Commission merely asserts that retaining the exemption "may not be appropriate" because the proposed position limit framework would set high limits and allow for exemptions and netting. 76 Fed. Reg. at 4762. This rationale should be reconsidered: if traders are truly independent from one another, then they should be treated independently and subjected to their own respective limits – regardless of how high or low the limit is.[8]

In an effort to address "some" of the concerns flowing from the elimination of the independent account controller exemption, the Commission proposes an "owned non-financial entity" exemption. *See id.* This proposed exemption allows an entity with a 10% or greater ownership or equity interest in a non-financial entity to disaggregate its positions from those of the owned non-financial entity where the owned non-financial entity is independently controlled and managed. Proposed Regulation 151.7(f). In justifying this exemption, the Commission explains that aggregating positions would be inappropriate where "operating companies may have complete trading and management independence and operate at such a distance from the holding company." *See* 76 Fed. Reg. at 4762.

This recognition of control as the touchstone for aggregation in the context of owned *non-financial* entities, but not in the context of *financial* entities is inexplicable, and the Commission does not even attempt to articulate a basis for the different treatment. Assuming the positions of both non-financial and financial entities could affect price (according to the proposal), there would be no reason for discriminating against financial entities. The Commission also fails to recognize the negative policy consequences of eliminating the independent account controller exemption and using the much more limited "owned non-financial entity" exemption.

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[8] The independent account controller exception is also hardwired into regulatory practices that extend beyond agricultural swaps and CFTC position limits. *See* CME Rule 559.E "Limited Exceptions to Aggregation for Independently Controlled Positions." The Commission does not seem to have considered these broader implications and has not advised the public whether it understands these rules and practices to still be viable.

Hypothetical 3[9]

An example illustrates these concerns. Assume that Asset Manager hires ITA A, an independent third-party, to control trading for Fund. On behalf of Fund, ITA A buys a 10% equity interest in three financial operating companies. Financial Company 1 is located in the United States, Financial Company 2 is located in Europe, and Financial Company 3 is located in Asia. Each Financial Company is independently controlled: Independent Manager 1 controls trading decisions for Financial Company 1, Independent Manager 2 controls trading decisions for Financial Company 2, and Independent Manager 3 controls trading decisions for Financial Company 3.

Under the proposed aggregation policy, Fund would be required to aggregate the positions of all three independent operating companies by virtue of its 10% ownership stake in each company, even though it would not be required to do so if the companies were non-financial in nature. The Commission's reason for disaggregating positions in commonly owned, but independently controlled non-financial companies, however, applies with equal force to similarly situated financial companies: companies that are related merely by a passive common ownership cannot be viewed as trading in concert with one another or as being under the influence of the common owner.

If, in the above example, Fund is not allowed to disaggregate the positions of the financial companies under its common ownership, several negative policy and business consequences will result. For one, the independent trading operations of the otherwise independently managed companies would need to communicate with each other as to their trading positions and intentions, thereby raising the potential for trading in concert. ITA A (on Fund's behalf) also may have to share proprietary trading information with the independently managed companies in order to allocate limited position volumes across these entities. The disclosure of such information, in turn, would compromise ITA A's abilities to comply with its fiduciary duties to its clients and to maintain the confidentiality of its trading strategies. Further, for firms that have global investments (like Fund), the operational aspects of compliance will be difficult to implement in a real-time system for U.S. trading hours. In fact, even if the financial companies were operating in the U.S., serious operational challenges would face Fund in attempting to comply.

BlackRock urges the Commission to retain the independent account controller aggregation exemption because that exemption is sound and sensible, has proven effective over decades with no reported or apparent abuses, and will not lead to the unintended, adverse consequences identified above.

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9 For a diagram of this example, see the appendix attached to this letter (Hypothetical 3).

C. *Implications for Funds of Funds and Separate Accounts*

In the context of a "fund of funds" ("FoF") structure, the application of the proposed aggregation rules leads to various unworkable and inadvisable results. A FoF refers to a tiered structure in which an asset manager advises a collective investment vehicle or separate account, which, in turn, invests all or a portion of its assets in independently advised collective investment vehicles (such as mutual funds, hedge funds, or private equity funds). FoFs offer investors the benefits of accessing professional management of a diversified pool of underlying funds. The following examples illustrate certain of the anomalous results that would occur with respect to FoF investments in independently advised and operated commingled investment vehicles or separate accounts if the Commission's proposed aggregation rules are adopted.

(i) Impact of Proposed Aggregation Rules on FoFs and Asset Managers

In a FoF structure, the FoFs do not control the trading decisions of the external funds in which they invest. However, under the Proposed Rules, these FoFs (as well as the asset manager) and certain of their investors, who are a further level removed from the investment decision-making, would still be accountable for positions held by those external funds as the following example illustrates.

Hypothetical 4[10]

Assume that Asset Manager advises two FoFs. The contributions to each FoF come from Investors, some of which own 10% of a FoF. Each FoF invests in numerous External Funds.[11] Each External Fund is advised by an independent ITA, each External Fund owns 100 crude oil contracts and the CFTC-prescribed position limit is 150 contracts. These External Funds may compete with each other for business, and each External Fund owes a fiduciary duty to its investors (including the FoFs). No FoF and no Investor controls the trading decisions of an External Fund.

If the Commission's proposal is adopted, the positions held by External Funds of which a FoF owns 10% would be attributed to that FoF for purposes of determining position limit compliance. In addition, based on informal discussions with CFTC staff, we understand that the positions attributed to a FoF would be "rolled up" to Asset Manager because Asset Manager would be deemed to "control" trading of the FoFs it advises.[12] The proposed aggregation rules would also increase the burden on the Investors in each of the FoFs. Specifically, any positions held by External Funds and attributed to a FoF would also be attributed to each Investor who owns 10% of a FoF.

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[10] For a diagram of this example, see the appendix attached to this letter (Hypothetical 4).

[11] For purposes of this example, we assume that 10% ownership would be sufficient to require aggregation, in accordance with Proposed Regulation 151.7(b), because the exclusions in Proposed Regulation 151.7(c) would not apply.

[12] Note that none of the External Funds would be required to aggregate their positions because each External Fund is advised by an independent ITA.

We believe that aggregation of this nature would not advance the Commission's purpose of preventing unreasonable and unwarranted prices that burden interstate commerce. Neither Asset Manager nor any FoF controls the trading of the External Funds. That role is filled by independent ITAs who do not coordinate their activities, and, in fact, are competing among themselves.

If the Commission requires aggregation in the absence of control, market participants will be less able to use FoF structures to diversify their portfolios. In our experience with independent ITAs for External Funds, these funds disclose portfolio position information infrequently to their direct investors (the FoFs) and generally on a significant time delay so as to protect the confidentiality of their trading strategies. Position-level information is never made available to second-tier investors, such as the Investors in the example.

If the Commission adopts its rules as proposed, we believe the result would be twofold. External Funds would either refuse to accept FoFs as investors or severely restrict investments made by managers of FoFs. As a consequence, asset managers will reduce their use of FoF structures, which will limit the ability of investors to use these structures diversify their portfolios and access otherwise attractive investment opportunities in underlying funds.

It is also instructive to consider how the proposed aggregation rules would "count" positions. In the example above, there are 4 External Funds, each of which hold 100 crude oil contracts, and there is a limit of 150 contracts. Under the proposed aggregation rules, all External Funds comply with the limit because each holds only 100 contracts. However, the FoFs do not comply with the limit, since each FoF must aggregate the positions held by the External Funds of which it owns 10%. This means each FoF would be deemed to hold 200 crude oil contracts. The Investors also do not comply with the limit: because each Investor owns 10% of a FoF, each Investor must aggregate the FoF's positions (200 crude oil contracts) with any other positions it holds. In this instance, the 200 crude oil contracts from the FoF put each Investor over the limit. Asset Manager does not comply with the limit, since all 400 crude oil contracts are rolled up to Asset Manager.

(ii) Application to Separate Accounts

Asset managers also advise separate accounts for clients. A separate account is an investment vehicle owned by a single party, like a pension fund. Under the Commission's Proposed Rules, separate account owners would be treated like the Investors in the example above. This means the positions held by external funds that are 10% owned by a separate account would be attributed both to the separate account holding the position and the owner of the separate account.[13] As with FoFs, external funds probably will not agree to share position information with separate account owners. Without this information, separate account owners will not know whether they comply with CFTC-mandated position limits and may reduce their

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[13] Positions attributed to a separate account would also be rolled up to the asset manager advising that separate account.

use of separate accounts. On the other hand, if the CFTC were to require external funds to report position-level information to separate account owners, external funds may refuse to accept investments from separate accounts in order to preserve the confidentiality of their trading strategies. In either case, separate account owners will lose an important diversification tool.

This result also illustrates a broader concern we have with the CFTC's proposal. Specifically, the aggregation rules will likely cause market participants to base investment decisions on their need to comply with artificial restraints on position ownership, rather than their view of a particular market. We believe markets work best when investors are able to choose among numerous trading strategies and oppose artificial restrictions on investor choice. We encourage the CFTC to adopt aggregation rules that do not attribute external positions to separate account owners.

D. *Establishment of Identical Trading Strategy Aggregation Rule*

The proposed "identical trading strategy" aggregation rule is also disconnected from the statutory purpose of preventing unreasonable or unwarranted price fluctuations. It would require a trader who controls the trading in or has *any* ownership or equity interest in multiple accounts or pools to aggregate positions in those accounts or pools as long as the accounts or pools have "identical trading strategies." *See* Proposed Regulation 151.7(d). The "identical trading strategy" rule, in effect, serves as an exception to the general 10% or greater ownership aggregation standard, allowing for aggregation at levels below 10% interest where there is not even a credible argument for de facto "indirect" control, never mind actual control. However, the precise scope of the rule is unclear given that the term "identical trading strategy" is not defined in the proposal. The Commission's only guidance is that the rule would apply where "a trader seek[s] a large long-only position in a given commodity through specific positions in multiple pools" and that the term "pool" includes "passively managed index funds." *See* 76 Fed. Reg. at 4762.[14]

BlackRock is concerned that, based on the Commission's guidance and the text of the proposed rule, the "identical trading strategy" aggregation rule could have broad reach. The rule would seem to require every passive investor in, or asset manager of, a long-only index fund to aggregate the positions of that fund with the positions of all other long-only index funds in which it invests or provides asset management services. This approach would not serve the statutory purpose of preventing unreasonable or unwarranted prices and would actually have negative effects on the market by severely restricting index fund activity.

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[14] Not all long index funds are alike or identical, of course. Many deploy different strategies for establishing and rolling positions, among others things. The Commission's proposal does not indicate whether these differences would make these funds non-identical.

Hypothetical 5[15]

The following example highlights the problems with the proposed rule: Investor 1 owns 1% of 5 long only index funds, each advised by different investment managers who were hired by Asset Manager. Investor 1 is a completely passive investor. Under what appears to be the plain meaning of the Commission's proposal, both Investor 1 and Asset Manager would be required to aggregate the long positions in *each* index fund – Investor 1 on the grounds of ownership interest in funds with identical trading strategies, and Asset Manager on the grounds that it exercises some form of control over the funds through hiring the investment managers of the funds. However, in reality, both Investor 1 and Asset Manager do not have any ability to affect market prices, let along manipulate them, through, respectively, their passive investments in and non-trading management of multiple long-only funds. The Commission's proposed "identical trading strategy" aggregation rule thus lacks any nexus to the statutory purpose of preventing unreasonable or unwarranted price fluctuations.

Forcing a passive investor or an asset manager that does not exercise trading control to aggregate all of the positions of every long-only (or short-only) index fund in which it invests or that it administers (but does not control trading for) would also have major policy consequences. If index funds receive enough investor capital to hold positions at or near the position limit, Investor 1 in the example would only be able to invest in *one* fund. For its part, Asset Manager might only be able to administer *one* fund. If Investor 1 were to invest in or Asset Manager were to establish two long-only index funds, then they would, under the proposal, have to aggregate the positions of both funds and face the possibility of unknowingly exceeding the limit. (The proposal's terms suggest that Investor 1 would be considered to own all of the positions on the two funds, not a pro-rata portion of the funds representing just Investor 1's investment interest.) The "identical trading strategy" aggregation rule would thus have the effect of constraining the ability of market participants to invest in index funds or manage such funds through third parties, which, in turn, would impair the businesses of the underlying funds. BlackRock opposes the proposed rule on the grounds that it is unnecessary and detrimental to the market. The next section discusses in more depth how the proposed position limit regime, as applied to index funds, will curb legitimate trading and have negative effects on the market.

III. Application of the Proposed Position Limit Regime to Commodity Index Funds Will Unnecessarily Disrupt Commodity Index Strategies and Reduce the Valuable Market Liquidity Provided by Those Funds.

Commodity index investors seek exposure to commodities through passive long-term investment in the various commodities making up a specified commodity index. Commodity exposure offers a recognized way to balance an overall portfolio given that historically commodity returns tend to be negatively correlated to stock market and bond market returns. BlackRock's commodity index strategies, in particular, have an orderly approach and longer term objectives in order to achieve optimal outcomes for our clients, many of whom themselves

[15] For a diagram of this example, see the appendix attached to this letter (Hypothetical 5).

are charged with the management of retirement savings and the investment assets of hundreds of thousands of beneficiaries.

The Commission's staff also has recognized that, because commodity returns are often positively correlated with inflation, commodity index investors can be seen as investing in commodities as a means to hedge against rising inflation. If the purpose of a commodity index investor's investment is a hedge, then the purpose of the trading that represents the investment (i.e. the taking of futures and swap positions in the index-specified commodities) should also be considered a hedge. We urge the Commission to use its exemptive authority under Section 4a(a)(7) to recognize the nature of most index fund investors as hedgers.

Moreover, imposing position limits on commodity index funds is not "necessary" given the lack of any empirical evidence to support a causal connection between those funds and commodity price volatility. Just a month ago, Barclays Capital published a report that reviewed empirical data on index positions and commodity prices and concluded that "those commodities that have experienced the biggest price increases have also seen either only very small increases in index long positions or even *outright declines* and vice versa." *See* Barclays Capital, Commodities Research Report at 6 (Feb. 24, 2011) (emphasis added). New empirical data also showed that index positions in different markets tend to move counter to price direction and therefore act as a *stabilizing influence* on price. *See id.* at 7. Even the Commission's own research on index funds confirms that these funds have not caused fluctuations in the prices of physical commodities. *See, e.g.*, CFTC, Staff Report on Commodity Swap Dealers & Index Traders at 27-30 (Sept. 2008). Commissioner Dunn made the point simply when he stated, "[p]rice volatility exists in markets that have substantial participation from index funds and markets that do not have any index fund participation whatsoever." *See* Dunn Opening Statement.

Limits on index fund positions are not only "unnecessary" to prevent price volatility, but they will also undermine, rather than advance, the other statutory goals identified in CEA Section 4a(a)(2) – namely, ensuring sufficient market liquidity for hedgers and protecting the price discovery function of the underlying market. The proposed limits, coupled with the proposed aggregation policy, would have the negative effect of reducing the participation of commodity index funds in the futures markets and the liquidity that these funds provide for commercial hedgers and price discovery. As the 2010 OECD Report noted, "[t]his [loss of liquidity] could make commodity futures markets less efficient mechanisms for transferring risk from parties who do not want to bear it to those that do, creating added costs that ultimately are passed back to producers in the form of lower prices and to consumers as higher prices." This harm to hedgers will be especially acute in the deferred months where most hedging occurs and where most hedgers need liquidity to hedge efficiently.

To the extent the Commission has any legitimate concerns with the potential for index funds to cause unreasonable or unwarranted price fluctuations, BlackRock urges the Commission to pursue, more effective, less disruptive market surveillance tools such as the position visibility levels discussed below.

IV. The Proposed Exemptions from Position Limits Are Unduly Narrow and Should Be Interpreted More Broadly So as Not To Constrain Legitimate Hedging Activity and Otherwise Create Market Disruptions.

A. *Bona Fide Hedging*

BlackRock agrees with other commentators that the Commission's proposed definition of "bona fide hedging" is unduly restrictive. The proposed definition in part requires that a "bona fide hedging" transaction or position represent a substitute for a transaction or position in the physical marketing channel. *See* Proposed Regulation 151.5(a). Further, a swap dealer's futures positions would only qualify as "bona fide hedging" if they were used to offset a swap with a counterparty that meets the narrow "bona fide hedging" definition. This limited "look through" exemption would therefore not apply to futures positions that offset risk from trades with, for instance, a pension fund that is using swaps to hedge or mitigate risks directly associated with the operation of the fund. Consequently, swap dealers would be constrained in their ability manage the residual risk of their swap book by undertaking offsetting transactions in the futures markets.

BlackRock encourages the Commission to harmonize its understanding of "hedging" for position limit purposes with the more accurate "hedging" definitions used for purposes of the commercial end user exemption from the clearing and exchange-trading mandates and for purposes of the major swap participant definition. To this end, the Commission should use its broad new exemptive authority under CEA Section 4a(a)(7)[16] to grant exemptions to market participants who use futures, options, or swaps when economically appropriate to the reduction of risks they face in their enterprises. This standard is consistent with the Commission's proposed "hedging" definition for commercial end user exemption. *See* End-User Exception to Mandatory Clearing of Swaps, 75 Fed. Reg. 80747, 80752 (Dec. 23, 2010) (noting that Proposed Regulation 39.6(c)(1)(i) "covers swaps used to hedge or mitigate *any* of a person's business risks," as outlined in six broad categories) (emphasis added).

By interpreting "hedging" more broadly through its section 4a(a)(7) exemptive power, the Commission will help ensure that market participants with legitimate commercial and financial hedging needs do not internalize their risk or shift their trading to other venues or instruments that fall outside of the CFTC's position limit authority. Ultimately, then, a broader understanding of "hedging" will promote the liquidity and protect the price discovery function of CFTC-regulated markets.

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[16] CEA Section 4a(a)(7) gives the Commission unprecedented authority to exempt from any position limit rule, without or without conditions, "any person or class of persons, any swap or class of swaps, any contract of sale for future delivery or class of such contracts, any option or class of options, or any transaction or class of transactions."

B. *Pre-existing Positions*

The Commission's proposal also provides an exemption from position limits for "pre-existing positions." This exemption covers positions established in good faith prior to the effective date of the limits, but not positions established post-effective date even if they are roll-overs that index funds have disclosed to their investors (and others) will occur. BlackRock agrees with other commenters that market disruptions will likely result if index funds' roll-over positions are not exempted from the limits and the funds are then forced to liquidate the portion of their roll-over that exceeds the limit. We therefore support having the Commission grandfather roll-over positions to allow for orderly trading without the threat of front-running. We also suggest that the Commission might allow for a phase-in exemption for positions established before the limits take effect of maybe a year or even more. This would minimize any shocks to the market that would result from forced liquidation.

VII. The Proposed Class Limits Do Not Address Excessive Speculation Concerns and Will Create Unnecessary Compliance Costs.

The Commission proposes to impose both class limits and aggregate limits outside of the spot month. Aggregate limits would apply to all futures, options, and economically equivalent swaps based on the same underlying commodity, and would allow for netting across contract classes. This approach reflects the economic reality that a trader with 1000 long futures and 998 economically equivalent short swaps has a true speculative position of only 2 long futures. Because aggregate limits target a trader's actual and total speculative position holdings, they are properly designed to prevent excessive speculation.

Class limits distort economic reality by essentially keeping futures and swaps in separate "silos" even though the swaps subject to the Commission's proposal are by law *economically equivalent* to futures. The Commission explains that class limits are meant to "ensure that market power is not concentrated in any one submarket." 76 Fed. Reg. at 4759. This stated rationale, however, is not tied to the statutory purpose in section 4a(a)(1) of diminishing, eliminating, or preventing excessive speculation causing unreasonable price fluctuations. And, even if the "submarket concentration" rationale were grounded in the statute, the Commission fails to show how the "silos" it creates (i.e. separate limits) are an accurate measure of the concentration of submarket power which can not be addressed by other regulatory means and, if they are, why aggregate limits are also needed, as the Commission has proposed.

Given that the proposed aggregate limits reflect economic reality and could possibly serve the statutory purpose of preventing excessive speculation because they focus on a trader's actual speculative position, BlackRock believes that the proposed class limits are unnecessary and will only create a greater administrative and compliance burden for market participants.

VIII. The Proposed Annual Recalculation of Limits Based on Open Interest May Lead to Progressively Lower Limits and, In Any Event, Will Create Uncertainty for Market Participants.

As some commentators have noted, the annual recalculation of non-spot-month position limits based on open interest will likely result in lower open interest levels and lower limits in successive years. The variability of position limits from year to year also will create uncertainty for market participants as to what limits will apply to their long-term trading strategies, causing some participants to shift their commodity-risk positions to markets with no limits at all or possibly even fixed limits. Though the Commission must strive to ensure that position limits do not cause price discovery to shift to trading on foreign boards of trade, its proposal fails to recognize that the proposed variable limits could very well have such an effect. *See* CEA § 4a(a)(2)(C).

If the Commission decides to impose any limits, it should reassess whether to use the same approach for setting limits that it uses under Part 150 for agricultural commodities – that is, establish a "hard cap" limit that stays in place until the Commission proposes and adopts a rule instituting new limits. Because the formal rulemaking process for adjusting position limit levels would involve public comment, market participants will have advanced notice of any potential changes and an opportunity to express their views on such changes.

IX. The Proposed Position Visibility Regulations Should Be Adopted In Lieu of Position Limits To Address Any Legitimate Market-Wide Surveillance Concerns.

BlackRock generally supports the concept underlying the proposed position visibility regulations as an appropriate additional surveillance tool. Those regulations would establish position visibility levels in metals and energy markets and require market participants to provide information the Commission may wish to see to ascertain the effect of traders' positions on markets. Our concern is that, as proposed, the visibility levels impose ongoing daily reporting obligations unrelated to positions in futures or economically equivalent swaps. These reports would be required whether the Commission has determined there is a specific surveillance need for the information or not, and the Commission estimates that the visibility level-related reporting requirements will cost market participants nearly thirty million dollars in annual labor, start-up, and maintenance costs. BlackRock believes this approach is not advisable and urges the Commission to consider whether the benefits of these proposed regulations outweigh their costs.

We understand that the Commission may intend its proposed position visibility regulations to essentially serve as federal position accountability rules. BlackRock would support revising the proposed position visibility regulations so that they actually function as federal accountability rules. As modified, the regulations should require participants who exceed a defined accountability level to provide information only when the Commission determines that market circumstances require such disclosure. The Commission could then take action targeted to address the threat – if any – posed by a particular trader or traders. Once a position accountability-type system is adopted to address the Commission's market-wide surveillance

concerns, the Commission should give that system a fair chance to work before determining that any hard federal position limits are "necessary."

For purposes of determining compliance with and computation of any position accountability levels that the Commission adopts, BlackRock recommends that the Commission subject market participants to the longstanding Part 150 aggregation rules rather than the proposed aggregation rules. As explained above, unlike the Part 150 rules, the proposed aggregation rules are not tailored to serve the statutory purpose of preventing unreasonable or unwarranted price fluctuations and will have unintended, negative policy consequences.

Conclusion

The Commission's position limit proposal may well have the most profound impact on our clients, our business and the markets we use of any Dodd-Frank proposal the Commission has issued relating to the already regulated markets. As this letter demonstrates, and the examples we have provided hopefully illustrate, the Commission's proposed rescission of its independent account controller approach to position aggregation and its replacement with a flawed alternative, would have major adverse impacts on our asset management business without any corresponding public benefits. Traders that make buy and sell decisions affect market prices. Position holders and owners, as well as asset and fund managers that have authorized professional advisors to control their trading can not affect market prices and should not be subject to aggregation. If the Commission decides that federal position limits are necessary and appropriate at all, we strongly urge the Commission to reconsider its aggregation proposal and to return to its traditional policy of focusing on who controls trading. In the absence of any evidence of abuse or wrongdoing, changing this policy at this time is simply not warranted and would undermine the price discovery and risk management purposes the futures markets are designed to serve.

In addition, BlackRock believes that Commission action now on position limits would be premature and inadvisable, especially in the other areas cited in this letter. The only exception should be federal accountability levels, which the Commission could adopt now to enhance its market surveillance powers.

BlackRock appreciates the opportunity to offer the foregoing comments on the Commission's Notice of Proposed Rulemaking regarding position limits for physical commodity derivatives. We hope the views and recommendations expressed herein prove helpful to the Commission and we are available to answer any questions the Commission may have.

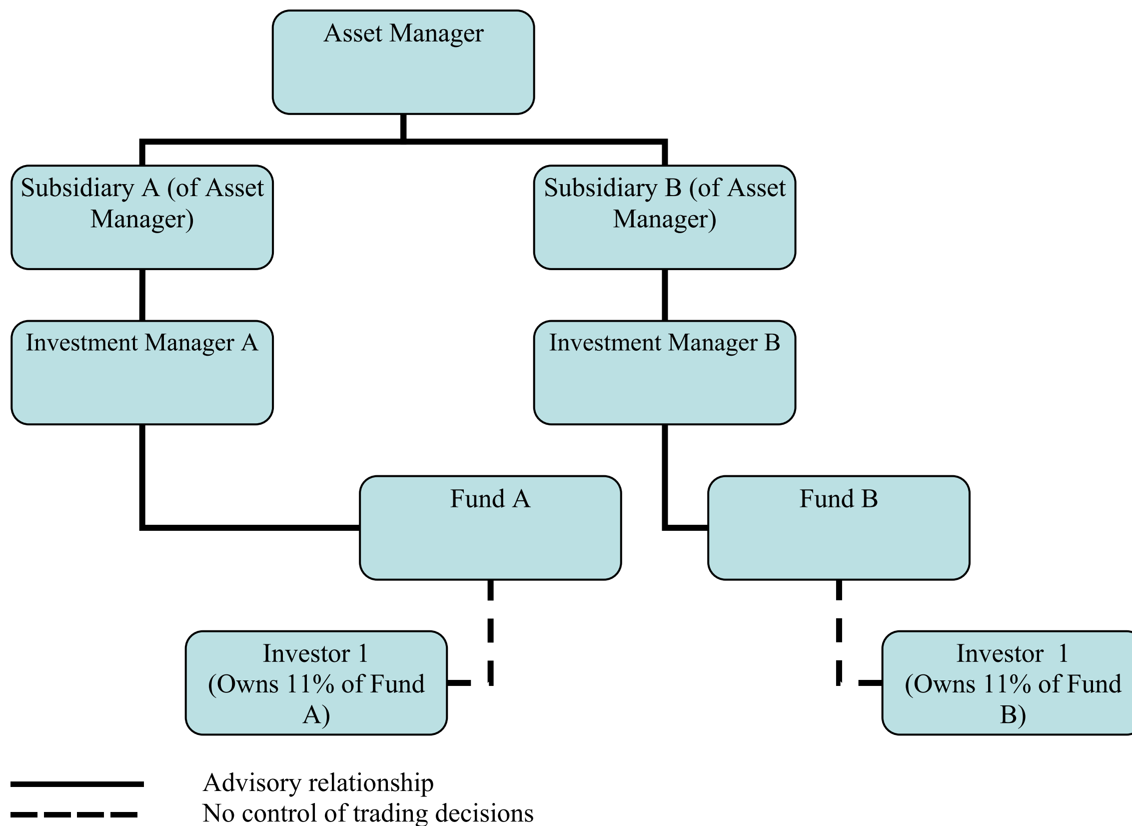
Sincerely,

Joanne Medero

APPENDIX

Hypothetical 1

Asset Manager has two subsidiaries: Subsidiary A and Subsidiary B. Each subsidiary hires an independent, third-party investment manager to manage trading for a certain fund: Subsidiary A hires Investment Manager A to manage Fund A; Subsidiary B hires Investment Manager B to manage Fund B. Investor 1 has an 11% ownership interest in each Fund. Investor 1 has a risk management practice whereby it will request that a fund's investment manager provide transparency regarding the fund's positions shortly after they have been established. Investment Manager A and Investment Manager B provide such information to Investor 1 upon request. Investor 1 has no control over the Funds' trading decisions.



Based on our understanding of the Commission's proposed aggregation policy, we believe the following aggregation requirements would apply:

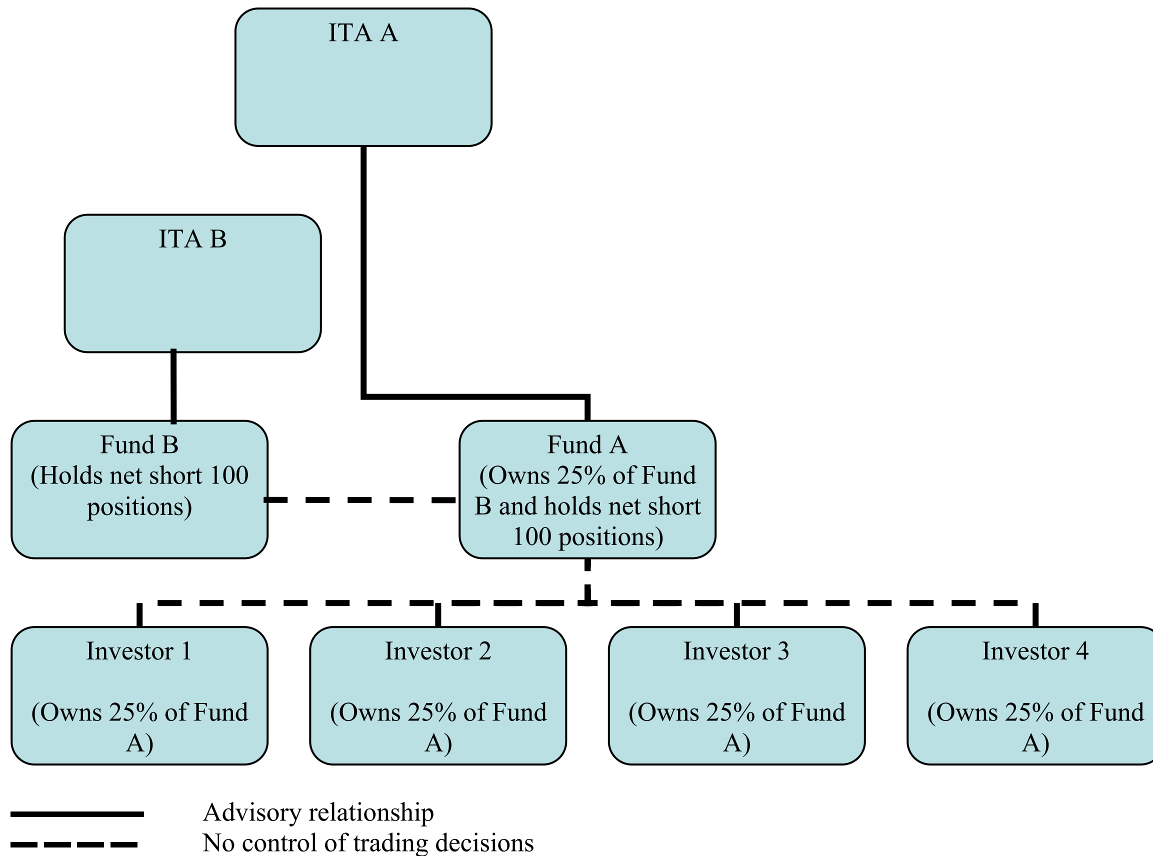
- **Investor 1** would be required to aggregate the positions of Fund A and Fund B because its ownership interest in each Fund is greater than 10% and it does not otherwise qualify for the passive pool participant exemption due to its risk management practice of receiving disclosure of position information.

- Each **Investment Manager** would be required to aggregate the positions of its respective Fund with those of any other funds that it manages because it controls the trading of the Fund's positions.

- **Asset Manager** would be required to aggregate the positions of Fund A and Fund B because Asset Manager would be viewed as exercising some form of "control" by virtue of its status as the parent entity of subsidiaries that control the funds' trading through investment managers. Informal discussions with Commission staff confirmed that Asset Manager would be deemed to "control" the trading of Fund A and Fund B so that the positions of Fund A and Fund B would be "rolled up" to and must be aggregated by Asset Manager.

Hypothetical 2

Investment and Trading Advisor ("ITA") A controls the trading of Fund A. Fund A has 4 investors (Investor 1, Investor 2, Investor 3, and Investor 4), each with a 25% ownership interest in Fund A. Fund A has a 25% ownership interest in Fund B but does not control Fund B's trading. ITA B controls the trading of Fund B and is independent (actually a competitor of) ITA A. Fund A and Fund B each hold net short 100 positions. The CFTC-prescribed position limit is 150 contracts.



Based on our understanding of the Commission's proposed aggregation policy, we believe the following aggregation requirements would apply:

- **Fund A** would be required to aggregate the positions that it holds with the positions that Fund B holds, *with no possibility of disaggregation*, because Fund A owns 25% of Fund B.

- ***Each* Investor** would have attributed to it Fund A's total positions, *with no possibility of disaggregation*, because each Investor owns 25% of Fund A. [17]

[17] Fund A's total positions would also be attributed to ITA A and the asset manager that hires ITA A (not pictured in diagram).

- **ITA A** would be required to aggregate the total positions of Fund A with the positions of any other Funds for which it controls trading because it controls Fund A's trading.

The effect of the required aggregation on position limit compliance is as follows:

- **Fund A** would be deemed to hold 200 net short positions and therefore would violate the position limit.

- **Investor 1** would be deemed to hold 200 net short positions and therefore would violate the position limit.

- **Investor 2** would be deemed to hold 200 net short positions and therefore would violate the position limit.

- **Investor 3** would be deemed to hold 200 net short positions and therefore would violate the position limit.

- **Investor 4** would be deemed to hold 200 net short positions and therefore would violate the position limit.

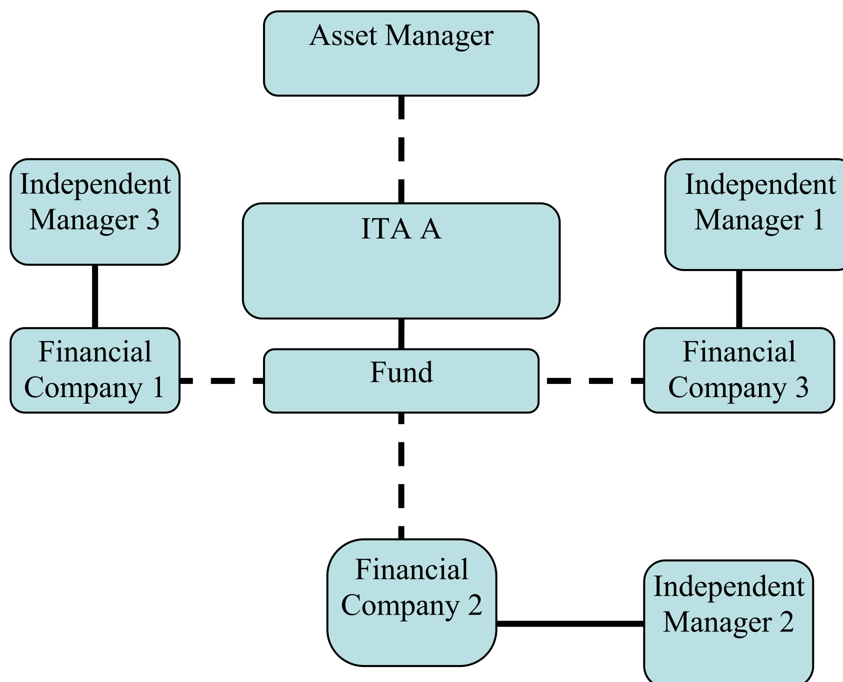
- **ITA A** would at the very least have to account for 200 net short positions and therefore would violate the position limit.[18]

- **Fund B** would comply with the position limit because it holds net short 100 positions and would not be deemed to hold any other positions based on the facts provided above.

[18] ITA A's net position would be greater if it also controlled the trading of other funds.

Hypothetical 3

Asset Manager hires Investment and Trading Advisor ("ITA") A, an independent third-party, to control trading for Fund. On behalf of Fund, ITA A buys a 10% equity interest in three financial operating companies. Financial Company 1 is located in the United States, Financial Company 2 is located in Europe, and Financial Company 3 is located in Asia. Each Financial Company is independently controlled: Independent Manager 1 controls trading decisions for Financial Company 1, Independent Manager 2 controls trading decisions for Financial Company 2, and Independent Manager 3 controls trading decisions for Financial Company 3.



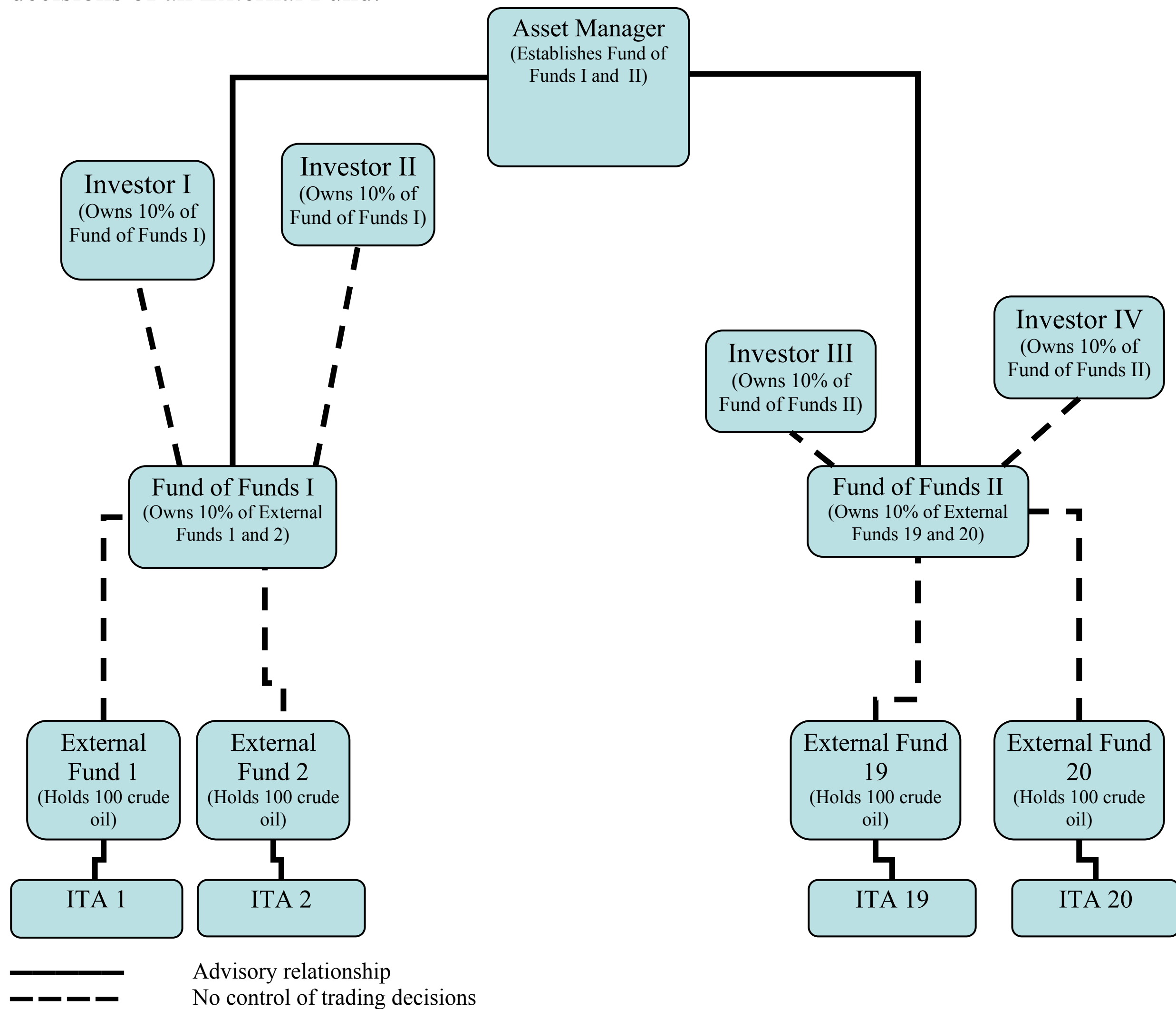
Advisory relationship
No control of trading decisions

Based on our understanding of the Commission's proposed aggregation policy, we believe the following aggregation requirement would apply:

- **Fund** would be required to aggregate the positions of all three independent operating companies by virtue of its 10% ownership stake in each company. Such aggregation would not be required, however, if the operating companies were non-financial in nature.

Hypothetical 4[19]

Asset Manager establishes two FoFs (Fund of Funds I and II). Investors I and II each own 10% of Fund of Funds I, while Investors III and IV each own 10% of Fund of Funds II. Each FoF invests in certain of External Funds 1-20 (only External Funds in which a FoF owns 10% are displayed). Each External Fund is advised by an independent Investment and Trading Advisor ("ITA"). Each External Fund holds 100 crude oil contracts and the CFTC-prescribed position limit is 150 contracts. Neither the Asset Manager nor any FoF or Investor controls the trading decisions of an External Fund.



19 For purposes of this hypothetical, we assume that 10% ownership would be sufficient to require aggregation, in accordance with Proposed Regulation 151.7(b), because the exclusions in Proposed Regulation 151.7(c) would not apply.

Based on our understanding of the Commission's proposed aggregation policy, we believe the following aggregation requirements would apply:

- **Fund of Funds I** would be required to aggregate the positions of External Funds 1 and 2 because it owns 10% of each External Fund.

- **Fund of Funds II** would be required to aggregate the positions of External Funds 19 and 20 because it owns 10% of each External Fund.

- **Asset Manager** would be required to aggregate the positions of Funds of Funds I and II because it would be viewed as exercising some form of "control" by virtue of its status as a parent entity. This assessment is based on informal discussions with Commission staff.[20]

- **Investors I and II** would be required to aggregate the positions of Fund of Funds I (i.e., the positions held by External Funds 1 and 2) due to the 10% ownership rule.

- Similar attribution would result for **Investors III and IV** with respect to Fund of Funds II.

The effect of the required aggregation on position limit compliance is as follows:

- Each **External Fund** holds 100 contracts and would comply with the limit.

- Each **FoF** would be deemed to hold 200 crude oil contracts and would violate the limit.

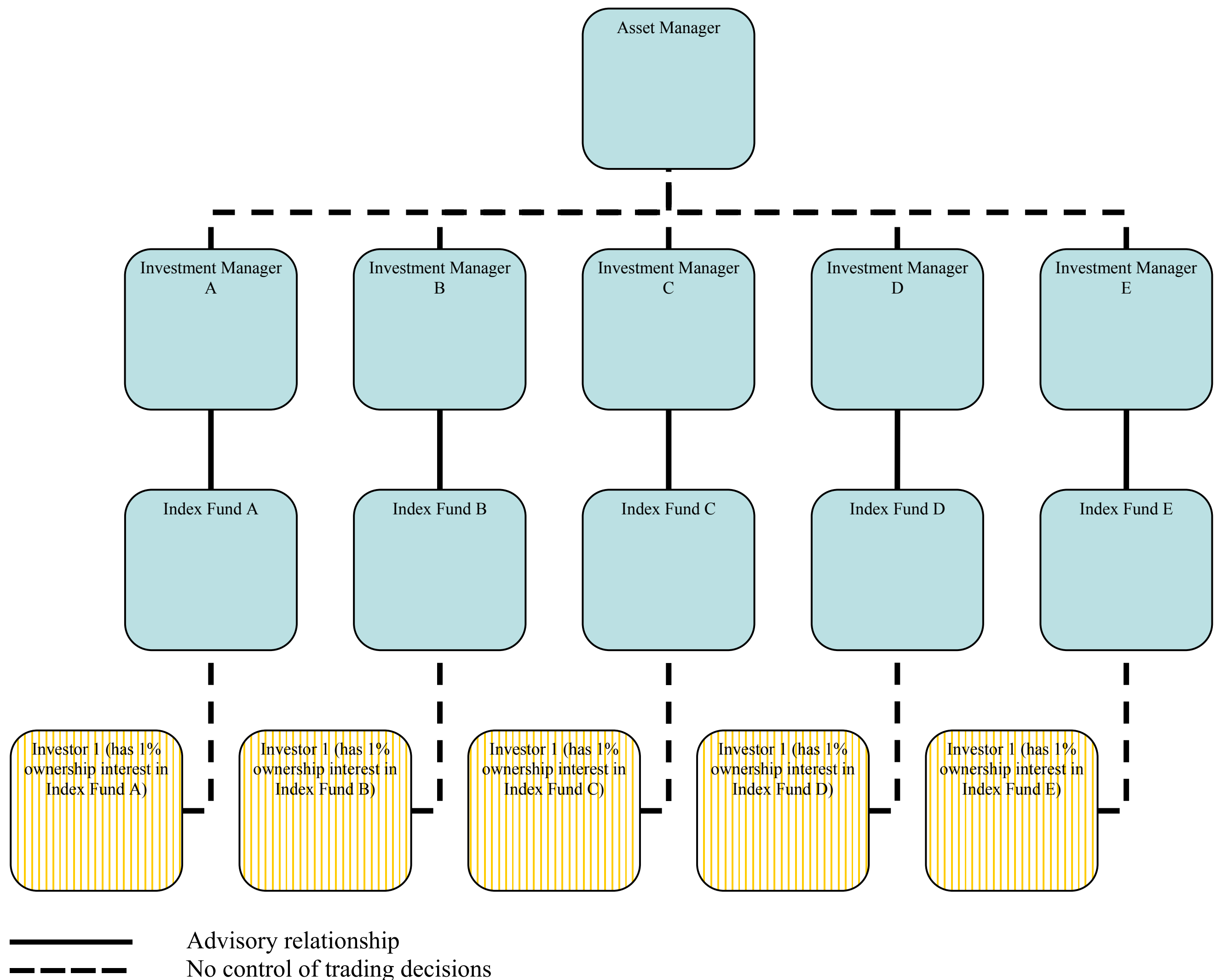
- Each **Investor** in a FoF would be deemed to hold 200 crude oil contracts and would violate the limit.

- **Asset Manager** would have to account for 400 crude oil contracts and would violate the limit.

[20] Note that none of the External Funds would be required to aggregate their positions because each External Fund is advised by an independent ITA.

Hypothetical 5

Investor 1 owns 1% of 5 long only Index Funds, each advised by different Investment Managers who were hired by Asset Manager. Investor 1 is a completely passive investor.



Based on our understanding of the Commission's proposed aggregation policy, we believe the following aggregation requirements would apply:

- **Investor 1** would be required to aggregate the long positions in *each* index fund by virtue of its ownership interest in funds that have what the Commission considers to be "identical trading strategies." The proposal is silent on whether Investor I aggregates only pro-rata portions or the entire position of each Index Fund.

- Each **Investment Manager** would be required to aggregate the positions of its respective Index Fund with those of any other funds that the Investment Manager controls because it controls the trading of the index fund's positions.

- **Asset Manager** would be required to aggregate the long positions in *each* index fund under the theory that it exercises some form of control over the funds through hiring the Investment Managers of the Funds.