



BRAD SHERMAN

MEMBER OF CONGRESS

April 12, 2011

The Honorable Gary Gensler, Chairman
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
Washington, DC 20581

Re: Position Limits Pilot Program for Diversified Mutual Funds

Dear Chairman Gensler:

I am writing today to voice concerns regarding the Commodity Futures Trading Commission's ("CFTC") proposed rule to establish position limits as authorized by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank"). I urge the CFTC to implement position limits in a manner consistent with Congressional intent and consider establishing a pilot program for diversified mutual funds so that the funds and their swap counterparts will be able to continue to access the markets. Specifically, position limits would not apply to such a pilot program unless the CFTC had made a determination, based on comprehensive economic analysis and a full understanding of position limits' impacts on market participants, that it was appropriate to apply them.

Despite its mandate to establish position limits "as appropriate," the CFTC's current rule proposal would establish formulas for determining position limits without the benefit of comprehensive data on the size of the swaps markets. Further, the proposed rule broadly sets position limits, ignoring the CFTC's discretion to establish different position limits for different classes of traders. I am concerned that moving forward in such a manner, without the benefit of economic data on the swaps markets or consideration of the rule's impact on various market participants, could lead to reduced liquidity and higher costs for investors, with no corresponding regulatory benefit.

In particular, I am concerned that flawed position limits could harm diversified mutual funds by restricting the size of their positions and limiting the hedging services provided by financial intermediaries to diversified mutual funds. This could have a serious adverse effect on the ability of diversified mutual funds to conduct their business and service their clients. Diversified mutual funds that invest in swaps or commodity futures contracts to replicate the performance of commodity indices play an important role in the markets. They and their swap counterparts serve as a source of liquidity, facilitate price discovery, and provide price stability. Further, these funds are fully collateralized, highly regulated by the SEC, and pose no systemic risk to the markets. Additionally, since these mutual funds are designed to track the performance of the underlying commodity markets by tracking an index, they do not engage in the price

manipulation or excessive speculation that position limits are meant to prevent. Consequently, there seems to be no factual or economic basis justifying the imposition of position limits on such funds.

Despite the distinguishing characteristics of passive, unleveraged diversified mutual funds, the proposed rule would treat them identically to other traders. Indeed, the proposed rule does not differentiate between investors who track a broad-based index and true speculators who actively manage their investments based on the price of a particular commodity. The CFTC's failure to consider the individual circumstances of market participants under the proposal is contrary to both Congressional intent and the text of the statute. If the CFTC proceeds along the lines outlined in its proposed rule, it could cause unnecessary harm to the commodity markets and small investors, who have come to rely on such funds as a cost-effective way to diversify their portfolios and hedge against inflation. In a letter dated December 16, 2010, Senate Agriculture Committee Chairman Blanche Lincoln underscored this sentiment: "as the CFTC seeks to implement position limits, I urge the CFTC not to unnecessarily disadvantage market participants that invest diversified and unleveraged commodity indices."

I am mindful that during the House Financial Services Committee Hearing on the implementation of Title VII on February 15, 2011, you responded to my questioning by saying you were keeping an "open mind" on the issue of different position limits for different classes of investors. I take you at your word. As the CFTC reviews the numerous comment letters submitted, I hope it carefully considers how different classes of traders may be impacted by position limits, and crafts the final rule accordingly to establish appropriate limits.

I also urge the CFTC to use this review period to perform a full cost-benefit analysis of the position limits proposed rule, similar to that called for under President Obama's recent Executive Order. I am deeply troubled by Commissioner Sommers' February 24th statement highlighting the CFTC's disregard for the economic costs of the rules it is proposing:

"Clearly, when it comes to cost-benefit analysis, the Commission is merely complying with the absolute minimum requirements of the Commodity Exchange Act. That is not in keeping with the spirit of the President's recent Executive Order on Improving Regulation and Regulatory Review. We owe the American public more than the absolute minimum . . . And we should most certainly attempt to determine whether the costs outweigh the benefits. The public deserves this information and deserves the opportunity to comment on our analysis. That is good government. Our failure to conduct a critical analysis of costs and benefits simply because we are not required to is not good government."

I appreciate the Herculean task before the CFTC as it strives to promulgate a staggering number of highly complex rules. While I recognize the challenges the CFTC faces in implementing Dodd-Frank, I expect the CFTC to fulfill its statutory obligation to establish position limits "as appropriate." Accordingly, I anticipate that any position limits established will be the result of a thoughtful, analytical process that considers both Congressional intent and the cost-benefits of the proposal. To that end, I strongly encourage the CFTC to exercise its

discretion under Dodd-Frank and consider adopting a pilot program for diversified mutual funds in conjunction with any established position limits.

I look forward to an ongoing discussion of the implementation of position limits at future oversight hearings and thank you for your consideration of this letter.

Sincerely,



Brad Sherman
Member of Congress

Cc: The Honorable Michael Dunn, Commissioner
The Honorable Jill E. Sommers, Commissioner
The Honorable Bart Chilton, Commissioner
The Honorable Scott D O'Malia, Commissioner