KANSAS CITY
BOARD OF TRADE

August 17, 2011

Submitted via e-mail

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

Re: Position Limits for Derivatives (RIN 3038–AD15 and 3038 AD16) (Federal Register Vol. 76, No.17, Page 4752)

Dear Mr. Stawick:

The Kansas City Board of Trade (KCBT) appreciates the opportunity to provide additional comment on the Commodity Futures Trading Commission's (CFTC or Commission) Notice of Proposed Rulemaking regarding position limits for derivatives. While we remain concerned with other aspects of this rule proposal as noted in our earlier comments submitted on March 28, 2011, we would like to reiterate and expand upon our concerns with the conditional spot month limits proposed for financial contracts that cash-settle to core referenced futures contracts.

This proposal would permit speculators in financial contracts, who hold no positions in the core referenced futures contract, to hold up to five times (5X) a core contract's spot month limit while also holding up to 25% of the core referenced futures contract's deliverable supplies. We are concerned that the Commission is acting contrary to both Sections 15(a) and (b) of the Act (discussed later in the letter) and the guidelines set forth in Section 4a(a)(3) of the Act in establishing position limits. Specifically, Section 4a(a)(3) states that in establishing position limits the Commission shall, to the maximum extent practicable:

(i) Diminish, eliminate or prevent excessive speculation;
(ii) Deter and prevent market manipulation, squeezes and corners;
(iii) Ensure sufficient market liquidity for bona fide hedgers; and
(iv) Ensure that the price discovery function of the underlying market is not disrupted.

KCBT believes that spot month position limits are an important tool to avoid the potential for non-commercial interference with the orderly liquidation of a contract month by encouraging the liquidation or rolling forward of large speculative positions prior to such contract month's delivery period. However, the proposed conditional spot month limits seem to run contrary to this concept by providing a means for large speculative interests to remain in the market well into the spot month period using financial contracts directly tied to the pricing of core physical contracts.

This is particularly troublesome given that the spot month is the period when core referenced futures contracts are in the process of converging with underlying cash market values and could be susceptible (through arbitrage) to the influence of the much larger financial contract position limits, potentially disrupting the orderly liquidation of core contracts. In fact, in recent years KCBT and other exchanges have taken measures to limit the participation in core referenced futures contracts by speculative interests during the spot month period, both through modest spot month position limits and in delivery accumulation provisions that prevent speculative interests from having an excessive or disruptive impact on the physical delivery function.

One of the key components in the convergence process is the availability of cash commodity in deliverable position to promote the orderly liquidation of contracts to avoid physical delivery. While currently there are no restrictions on the amount of deliverable supplies that a speculator can own or control, the modest core contract position limits make it difficult for such a speculator to bring excessive supplies to bear on the core contract through physical delivery. As an example, the current KCBT wheat spot month limit of 600 contracts equates to 3,000,000 bushels of deliverable commodity. This represents only 3% of the current KCBT wheat contract deliverable supplies of roughly 100,000,000 bushels. The proposed conditional limits also allow a speculator holding financial contracts in the amount of up to 5X the position limit of the core contract to also own or control up to 25% (in the case of KCBT wheat, 25,000,000 bushels) of the core contract's cash commodity in deliverable position. This creates the potential for a speculator holding large positions in the financial contract (that settles to the price of the core contract) to influence the price of the core contract (to the benefit of the financial contract positions) by withholding a significant quantity of deliverable supply from the market when the core contract nearby month spread pricing indicates that physical delivery should occur to foster convergence. In fact, the speculator is prevented from participating in the physical delivery process, since their conditional financial position limit prohibits them from holding a position in the core contract spot month.

As we stated in our earlier comments, we are concerned with the negative impact the conditional spot month limits could have on the liquidity of the core futures contracts for bona fide hedgers during the spot month period. The spot month is an important time for bona fide hedgers in rolling, liquidating or making/taking delivery of contracts. Given that the financial contracts settle based on or relative to the physical contract, it is possible (particularly during the spot month when open interest is generally lower and in liquidation mode), that the higher conditional spot month position limits could disrupt or unduly influence the price discovery function of the physical contract (the "tail wagging the dog" effect). In addition, the higher conditional spot month limits unduly restrict the physical market's ability to compete for spot month speculative trading interests, which provide additional liquidity to commercial market participants (bona fide hedgers). As a result, the core physical market becomes less useful to large commercial hedgers who depend on speculative participation in the spot period to take the opposite side when they choose to unwind or roll their hedge.

In addition to the Section 4a(a)(3) considerations detailed above, KCBT also believes that the proposed conditional spot month position limit provisions ignore the cost-benefit considerations under Section 15(a) of the Commodity Exchange Act, as well as the anti-competitive considerations under Section 15(b). We believe it was the intent of Congress through the Dodd/Frank Act to impose similar position limits on the unregulated markets to those in place for the regulated markets. Certainly the intent of Congress was not to create an environment of regulatory arbitrage via position limits through favorable treatment to financial contracts over core contracts.

We believe that the least anti-competitive means of implementing all position limits across referenced contracts (including spot month limits) would be through position limit parity. As has been the case with federal speculative position limits historically, it seems not only equitable but sensible to begin with limit parity and monitor reportable positions in all contracts for a time to determine whether increased limits are necessary.

In closing, we believe the disparate treatment envisioned by the Commission's proposed conditional spot month limits could encourage price manipulation in the delivery months and damage the critical price discovery function of the core physical contracts the Commission intends to protect. For this reason, as well as those detailed above, we request that the Commission maintain parity in all position limits (including spot month limits) between core physical and referenced financial contracts.

Sincerely,

Jeff C. Borchardt
President & CEO

Cc: Chairman Gary Gensler
Commissioner Michael Dunn
Commissioner Jill Sommers
Commissioner Bart Chilton
Commissioner Scott O'Malia
Steve Sherrod