CME Group

Craig S. Donohue
Chief Executive Officer

January 17, 2012

VIA ON-LINE SUBMISSION

David Stawick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Position Limits for Futures and Swaps (RIN No. 3038-AD17); (Federal Register Vol. 76, No. 223, Page 71626)

Dear Mr. Stawick:

CME Group Inc. ("CME Group")[1], on behalf of its four designated contract markets, appreciates the opportunity to comment on the Commodity Futures Trading Commission's (the "CFTC" or "Commission") Final Rule and Interim Final Rule ("Release") that was published in the Federal Register on November 18, 2011. In the Release, the Commission seeks comment on the interim final rule governing spot-month position limits applicable to physical delivery derivatives contracts and their cash-settled look-a-likes. Specifically, the Commission seeks comment on the application of spot-month position limits to cash-settled contracts using the same methodology as applied to the physical-delivery Core Referenced Futures Contract, *e.g.,* 25% of deliverable supply, other than the natural gas market, where cash-settled contracts are afforded a higher spot-month limit, which is described in detail in the Release.

As the Commission recognizes, spot-month position limits are a well-accepted regulatory tool employed by designated contract markets to avoid congestion, deter manipulation, and promote convergence of futures and cash markets. Spot-month limits for physical delivery contracts have long been set at 25% of the estimated deliverable supply of the underlying commodity as per guidance to DCM's in Part 38 of the Commission's Regulations. Indeed, as the Commission discusses in the Release:

> The Commission has determined to adopt the 25 percent level of deliverable supply for setting spot-month limits. This formula is consistent with the longstanding Acceptable Practices for Core Principle 5, which provides that, for physical-delivery contracts, the spot-month limit should not exceed 25 percent of the estimated deliverable supply. The use of the existing industry standard would provide clarity concerning the underlying methodology. Further, the Commission believes that, based on its experience, the formula has appeared to work effectively as a prophylactic tool to reduce the threat of corners and squeezes and promote convergence without compromising market liquidity.

[1] CME Group is the world's largest and most diverse derivatives marketplace. CME Group includes four separate Exchanges, including Chicago Mercantile Exchange Inc. ("CME"), the Board of Trade of the City of Chicago, Inc. ("CBOT"), the New York Mercantile Exchange, Inc. ("NYMEX") and the Commodity Exchange, Inc. ("COMEX"). The CME Group Exchanges offer the widest range of benchmark products available across all major asset classes, including futures and options based on interest rates, equity indexes, foreign exchange, energy, metals, agricultural commodities, and alternative investment products. CME includes CME Clearing, one of the largest central counterparty clearing services in the world, which provides clearing and settlement services for exchange-traded contracts, as well as for over-the-counter derivatives transactions through CME ClearPort®.

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With respect to all physical commodity derivative markets except those in natural gas, the Commission has determined that higher limits in cash-settled contracts during the spot-month would “permit larger position[s] [sic] in look-a-like cash-settled contracts that may provide an incentive to manipulate and undermine price discovery in the underlying physical-delivery futures market.” (Release at 71635.) The Commission goes on to explain that in all markets related to the 28 Referenced Contracts – except natural gas – “administrative experience, available data and trade interviews” lead the Commission to believe that swaps markets that are linked to or based on physical-delivery futures markets are small, from an open interest perspective, when compared to the physical-delivery futures market. Thus, the Commission concludes, parity between the physical-delivery contract and the cash-settled look-a-like “should ensure sufficient liquidity for bona fide hedgers” that use the cash-settled contract. (Release at 71636.)

With respect to the natural gas market, the Commission stated in the Release that “there are very active cash-settled markets both at DCMs and exempt commercial markets [and] . . . both NYMEX and ICE have gained experience with conditional spot-month limits in natural gas where the cash-settled limit is five times the limit for the physical-delivery futures contract. (Release at *Id.*) Further, the Commission asserts that the “existing conditional limits on cash-settled natural gas contracts have not materially diminished the price discovery function of the physical-delivery contract.” (Release at *Id.*)

Importantly, the Commission reasons in the Release that “the one-to-one ratio (between the level of spot-month limits on physical-delivery contracts and the level of spot-month limits on cash-settled contracts in agricultural, metals, and energy commodities other than natural gas) maximizes the objectives enumerated in section 4a(a)(3).[2] Specifically, such limits ensure market liquidity for bona fide hedgers and protect price discovery, while deterring excessive speculation and the potential for market manipulation, squeezes, and corners.” (Release at *Id.*). The Commission further explains that the interim final rule is “*consistent with the level the Commission staff has historically deemed acceptable for cash-settled contracts, as well as the formula for physical contracts under Acceptable Practices for Core Principle 5 in part 38.*” (Release at *Id.*, emphasis added.)

A policy of higher spot-month limits for cash-settled contracts in any linked market[3] is contrary to the longstanding joint policy of the Commission and the exchanges. Indeed, as the Commission notes in the Release, the Commission staff has historically deemed acceptable *both* for physical-delivery contracts and their cash-settled look-a-likes a spot-month limit of 25% of estimated deliverable supply. This is sound regulatory policy because for such linked contracts, any impact to physical supply is immediately

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[2] Section 4a(a)(3) of the Commodity Exchange Act (“CEA”), as amended by the Dodd-Frank Act (“DFA”), provides that in establishing limits, the Commission, as appropriate, shall set limits –

(A) On the number of positions that maybe 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; and
(B) To the maximum extent practicable, in its discretion –
  (i) To diminish, eliminate, or prevent excessive speculation as described under this section;
  (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.

CEA § 4a(a)(3).

[3] This is not to say, however, that similar concerns would not be present for cash-settled contracts that are economic equivalents to physical-delivery contracts with Federal limits, but are not part of a linked market. Indeed, the CEA, as amended by DFA, explicitly requires that the Commission impose similar limits on economically equivalent swaps. *See* CEA §4a(a)(5).

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translated to the physical contract settlement price by the laws of supply and demand, and necessarily to the settlement price of the cash-settled look-a-like given that it is settled to the physically-delivered contract.[4] Similarly, activity in the cash settled linked market is immediately translated in the underlying core physically settled market.

While we recognize that the threat of manipulation is not the only factor the Commission is required to consider when setting spot-month limits, surely the manipulation prong of the statutory four part test is entitled to considerable weight in the Commission's balancing. Nevertheless, the Commission has concluded that the natural gas market needs a higher spot-month limit for cash-settled contracts and leaves the door open for that same policy in other markets to ensure there is sufficient market liquidity for hedgers. Although we agree that the Commission is required to consider the factor of sufficient liquidity as well preventing manipulation when setting spot-month limits in all contracts, we believe that the first essential step in applying this factor is whether estimated deliverable supply – the key determinant of spot-month limit levels – is up-to-date and accurate. Specifically, the Commission is required to update deliverable supply estimates every two years for energy and metals Referenced Contracts and every year for agricultural Referenced Contracts. *See* CFTC Final Rule 151.4(d)(2). Any changes in the deliverable supply estimates would immediately translate into changes in the spot-month limit in the 28 Referenced Contracts since the spot-month limit is required to be set at a fixed 25% of estimated deliverable supply. Thus, without updated and accurate deliverable supply estimates and spot-month limit levels that have been updated accordingly, the Commission would be hard pressed to offer any reasoned analysis whether there is sufficient liquidity for bona fide hedgers in the linked physical delivery and cash-settled of contracts for any commodity and whether a higher ratio must be implemented in the cash-settled market to satisfy this factor notwithstanding the increased threat of manipulation that could result.

As the Commission knows, the deliverable supply estimates in many of the markets for Referenced Contracts – including natural gas and crude oil – have not been updated in years. In fact, it has been over 14 years since the deliverable supply estimates have been calculated for natural gas and almost 6 years for crude oil. CME Group has already begun its assessment of deliverable supply estimates in the relevant markets and has begun to discuss our assessment with the Commission's staff regarding certain preliminary results. We have been advised that the Commission's staff is conducting its own deliverable supply analysis, including for crude oil and natural gas. While this cooperative process is ongoing, our preliminary results lead us to expect the deliverable supply estimates that have been applied in the past to increase meaningfully.

With updated deliverable supply estimates for the relevant markets, a spot-month limit in linked markets that sets the limit at 25% of estimated deliverable supply for both the physical delivery contract and the cash-settled look-a-like is the best way for the Commission to address factors it is required to consider under CEA Section 4a(a)(3) and the most sound regulatory policy. Specifically, based on our consideration of deliverable supply thus far, updated deliverable supply estimates in the markets for the Referenced Contracts will ensure sufficient liquidity for bona fide hedgers in both the physical delivery contract and the cash-settled contract. Additionally, imposing the same limit in both the physical delivery and cash-settled contracts in linked markets is much more effective for purposes of diminishing, eliminating, and preventing excessive speculation and deterring and preventing market manipulation, squeezes, and corners than providing a higher limit in the cash-settled market. Finally, a ratio of 1:1 in

[4] With respect to the natural gas market, the Commission has observed that the cash-settled look-a-like contracts serve a price discovery function and that "prices on the ICE and NYMEX contracts have an *ongoing, linked relationship* that extends not only to the linked settlement price but to prices between the two contracts throughout the trading day." *See* Jeffrey H. Harris, Commodity Futures Trading Commission, Chief Economist, Testimony at Hearing to Examine Trading on Regulated Exchanges and Exempt Commercial Markets (Sept. 18, 2007), comparing the price discovery function of the NYMEX physically-delivered Natural Gas futures contract to that of the ICE cash-settled Natural Gas contract; *see also See October 2007 "Report on the Oversight of Trading on Regulated Futures Exchanges and Exempt Commercial Markets* Order Finding That the ICE Henry Financial LD1 Fixed Price Contract Traded on the Intercontinental Exchange, Inc., Performs a Significant Price Discovery Function, 74 Fed. Reg. 37988, 37989-90 (July 30, 2009).

linked markets does not provide any incentive for traders to exit the primary price discovery market, *i.e.*, the physical delivery futures market, which certainly could adversely impact liquidity and therefore price discovery in that market. Thus, based on the information available to the public at this time, we can think of no reason why parasitic cash-settled contracts require or deserve a higher spot-month limit than the principal physical delivery price discovery contract on which they are based.

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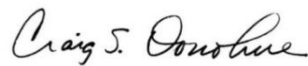
We appreciate the opportunity to submit comment on this important matter.[5] We welcome any comments or questions regarding the comments and views provided herein. Please feel free to contact me at (312) 930-8275 or Craig.Donohue@cmegroup.com, or Christal Lint, Director and Associate General Counsel at (312) 930-4527 or Christal.Lint@cmegroup.com.

Sincerely,



Craig S. Donohue

cc: Chairman Gary Gensler
Commissioner Bart Chilton
Commissioner Jill Sommers
Commissioner Scott O'Malia
Commissioner Mark Wetjen

[5] We reserve the right to submit further comment on the interim final rule and fully anticipate doing so. CME Group submitted a request pursuant to the Freedom of Information Act ("FOIA") in July seeking data and analyses the Commission reviewed and considered in conjunction with the subject matter covered by the interim final rule. In clear violation of the FOIA statute, the Commission has yet to fully or adequately respond to our FOIA request. Specifically, at approximately 5 p.m. Eastern on Friday, January 13, 2011 – the business day before this deadline for submitting comments on the Release – for the first time, the Commission sent to CME Group documents alleged to be responsive to our FOIA request. FOIA is a federal statute, not a petri dish for regulatory gamesmanship by a federal agency.

Moreover, with these files the Commission included a cover letter that stated, among other things, certain documents were being withheld under exemptions in the FOIA statute; the letter, however, does not contain any explanation whatsoever as to the types of documents being withheld or the rationale for the applicability of the exemptions. Significantly, the letter states that the Commission's "document review is continuing." Thus, we assume that, among other things, the Commission is likely to find additional documents responsive to our July FOIA request after today. As articulated in our initial FOIA request and all subsequent correspondence with the Commission since that time, any data and analyses reviewed, considered and/or performed by the Commission in conjunction with the proposed spot-month position limits rules and the interim final rule subject of this comment letter are critical not only to responding to our FOIA request but providing CME Group with the opportunity to make informed comment on the Commission's rulemakings related to spot-month position limits.

In addition to being in violation of the its FOIA statue, we believe that the Commission also is in violation of the Administrative Procedures Act ("APA") by failing to provide any such data and/or analyses to the public in the Release or in the notice of proposed rulemaking that preceded the Release. Such data and/or analyses are necessary for the public generally to provide informed comment on the interim final rule.

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