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January 17, 2012

Via Electronic Submission

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

Re: Positions Limits for Futures and Swaps (RIN 3038–AD17)

Dear Mr. Stawick:

The Futures Industry Association ("FIA") appreciates the opportunity to provide the Commodity Futures Trading Commission ("CFTC" or "Commission") with the comments and recommendations set forth below in response to the interim final rule regarding Position Limits for Futures and Swaps adopted by the Commission at its October 18, 2011 public meeting and published in the Federal Register on November 18, 2011 (the "Position Limits Rule").[1] The Position Limits Rule establishes new federal position limits for 28 physical commodity futures and options contracts ("Core Referenced Futures Contracts") and swaps that are economically equivalent to such contracts (collectively, "Referenced Contracts"), including interim spot-month position limits on cash-settled Referenced Contracts. FIA's comments and recommendations focus primarily on the Commission's erroneous decision to impose position limits on cash-settled Referenced Contracts without the factual record required to make the statutorily mandated finding that position limits on such contracts are "necessary" and, if so, that the particular position limits and related regulatory requirements are "appropriate."[2]

I. FIA's Interest in the Interim Spot-Month Position Limits on Cash-Settled Referenced Contracts and the Position Limits Rule

FIA's members, their affiliates, and their customers actively participate in the listed and over-the-counter derivatives markets as intermediaries, principals, and users. For this reason, FIA participated in the legislative process that led to the enactment of the Dodd-Frank Wall

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[1] Position Limits for Futures and Swaps, 76 Fed. Reg. 71,626 (Nov. 18, 2011).

[2] FIA consistently has commented that the Commission should not impose position limits on cash-settled contracts or physical-delivery Referenced Contracts without first finding that they are "necessary" as required by CEA Section 4a(a)(1). *See*, *e.g.*, Futures Industry Association, Comment Letter on Position Limits for Derivatives at 6 (dated Mar. 25, 2011).

Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"). In addition, FIA has assisted the CFTC and other federal agencies as they implement the Dodd-Frank Act by providing them with the information, comments, and recommendations that they need to ensure that the U.S. derivatives markets remain the most efficient and competitive in the world. As active participants in, and users of, the U.S. derivatives markets, FIA and its members have a significant interest in the interim spot-month position limits on cash-settled Referenced Contracts and the Position Limits Rule.

II. Preliminary Statement

FIA respectfully submits that the Position Limits Rule does not satisfy the statutory prerequisites for establishing position limits. This is particularly true with respect to cash-settled Referenced Contracts which, as the Commission has acknowledged, are not susceptible to excessive speculation or manipulation – the specific conditions that position limits are intended to eliminate or diminish.[3] Indeed, the Commission does not cite, and FIA is not aware of, any factual basis for concluding that position limits on cash-settled Referenced Contracts are "necessary to diminish, eliminate or prevent" the burden on interstate commerce caused by excessive speculation, or that the levels proposed by the Commission are "appropriate." Moreover, FIA has profound concerns about the very substantial costs and adverse effects that unnecessary and inappropriate new restrictions, imposed without adequate factual support, will have on the ability of market participants to trade Referenced Contracts.

Market liquidity, price discovery, the ability of hedgers to protect themselves against risk at a reasonable cost, and the overall competitiveness of the U.S. derivatives markets are too important to U.S. and international commerce to be the subject of a position limit experiment based upon unsupported claims about price volatility allegedly caused by speculative positions. FIA respectfully submits that the Commission has failed to assure Congress and market participants that the interim final spot-month position limits, prohibition on netting economically equivalent positions in the spot month, and new aggregation provisions will not adversely affect the liquidity and price discovery function of those markets, nor can it realistically do so until *after* it collects and analyzes information about the positions of market participants in the contracts for which the Commission has set limits.

In order to ensure that its regulations will not create substantial unintended (or even irreparable) harm to market participants, FIA urges the Commission to withdraw or substantially modify the Position Limits Rule, particularly the interim final spot-month position limits on cash-settled Referenced Contracts, until it has adequate information to regulate these important markets. Withdrawal of the Position Limits Rule is the only action that will ensure the

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[3] *See* 17 C.F.R. § 38, Appendix B (explaining that position limits are not necessary where the "threat of excessive speculation or manipulation is nonexistent or very low," including "contracts specifying cash settlement where the potential for distortion of . . . price is negligible").

Commission does not impair liquidity, efficient price discovery, and the ability of market participants to hedge against risk at a particularly fragile time for the U.S. economy. If, however, the Commission declines to withdraw the Position Limits Rule, FIA makes recommendations as to how the Commission can modify the interim final spot-month limits on cash-settled Referenced Contracts and other related provisions to mitigate the substantial adverse effects that the Position Limit Rule will have on FIA members, market participants, and the U.S. commodity and derivatives markets.[4]

III. Overview of the Interim Spot-Month Position Limits on Cash-Settled Referenced Contracts

The Position Limits Rule establishes spot-month position limits for cash-settled Referenced Contracts on an interim final basis using (except for cash-settled natural gas contracts) the same methodology based on 25 percent of estimated deliverable supply that applies to the physical-delivery Core Referenced Futures Contracts.[5] Without citing factual support for its conclusion, the Commission opined that "parity should exist in all position limits (including spot-month limits) between physical-delivery and cash-settled Referenced Contracts" in order to prevent larger positions in lookalike cash-settled contracts "that may provide an incentive to manipulate and undermine price discovery in the underlying physical-delivery futures contract."[6]

Nevertheless, in a departure from its general approach to position limits for cash-settled Referenced Contracts, the Commission stated that it "has a reasonable basis to believe that the cash-settled market in natural gas is sufficiently different from the cash-settled markets in other physical commodities to warrant a different spot-month limit methodology."[7] Citing the "very active cash-settled markets both at designated contract markets ("DCMs") and exempt commercial markets" for natural gas Referenced Contracts, the Commission adopted a class limit for cash-settled NYMEX Henry Hub Natural Gas Referenced Contracts and an aggregate limit for physical-delivery and cash-settled NYMEX Henry Hub Natural Gas Referenced Contracts equal to five times the level of the limit for the physical-delivery Core Referenced Futures Contract.[8]

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[4] Many of FIA's comments regarding the interim spot-month position limits on cash-settled Referenced Contracts apply with equal force to position limits on the physical-delivery Core Referenced Futures Contracts.

[5] 76 Fed. Reg. at 71,635.

[6] *Id.*

[7] *Id.*

[8] 76 Fed. Reg. at 71,636.

Although the Commission eliminated class limits in the non-spot months, the Position Limits Rule prohibits netting economically equivalent physical-delivery and cash-settled positions in the spot-month.[9] The Position Limits Rule also requires entities to aggregate all positions in Referenced Contracts, including cash-settled Referenced Contracts, that are commonly held by entities with ten percent or greater common ownership or commonly controlled. The Position Limit Rule provides only limited exemptions from the aggregation requirement for, among other things, financial entities that hold client positions that are managed by an independent account controller (but not in the spot-month), entities engaged in certain types of underwriting activity, and instances where aggregation across commonly-owned entities would require sharing of position information in violation of federal law.

In response to comments expressing substantial concern over the procedure by which the Commission imposed position limits for cash-settled Referenced Contracts, the Commission elected to establish spot-month limits for cash-settled Referenced Contracts on an interim final basis in order to solicit further comments from the public. In particular, the Commission requested comments on whether a different ratio (*e.g.*, one-to-three or one-to-four) for setting spot-month limits in cash-settled Referenced Contracts can further the statutory objectives in the Commodity Exchange Act ("CEA") Section 4a(a)(3)(B) of:

1. diminishing, eliminating or preventing excessive speculation;
2. deterring and preventing manipulation;
3. ensuring sufficient market liquidity for *bona fide* hedgers; and
4. ensuring that the price discovery function of the underlying markets is not disrupted.[10]

The Commission also solicited comment on the various costs and benefits associated with the interim spot-month limits, and on the impact of the interim final rule or any alternative ratio on:

1. the protection of market participants and the public;
2. the efficiency, competitiveness, and financial integrity of the futures markets;
3. the market's price discovery functions;
4. sound risk management practices; and
5. other public interest considerations.[11]

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[9] Netting physical-delivery and cash-settled positions is required when calculating the aggregate position limit for NYMEX Henry Hub Natural Gas Referenced Contracts.

[10] 76 Fed. Reg. at 71,638; *see also* CEA Section 4a(a)(3)(B).

[11] 76 Fed. Reg. at 71,638.

IV. Summary of FIA's Comments and Recommendations

For the convenience of the Commission and its Staff, set forth below is a summary of FIA's comments on the interim final spot-month position limits and related issues in the Position Limits Rule:

- The Commission should withdraw the Position Limits Rule, including the interim spot-month position limits on cash-settled Referenced Contracts, until *after* it has collected and analyzed the data needed to make the statutorily required finding that:

  - Limits on cash-settled Referenced Contracts are "necessary" to "diminish, eliminate, or prevent" the burden on interstate commerce caused by excessive speculation; and

  - If limits are necessary, then the limit levels imposed by the Commission are "appropriate."

  This is the only approach that is consistent with the Commission's statutory responsibilities and the current record before it.

- If the Commission does not withdraw the interim spot-month position limits on cash-settled Referenced Contracts, then, at a minimum, it should take the following steps to reduce the adverse effects of the Position Limits Rule:

  - Establish higher and less restrictive spot-month position limits on cash-settled Referenced Contracts rather than automatically utilizing the same percentage of deliverable supply formula for different contracts linked only by a common underlying commodity;

  - Provide a six-month safe harbor transition period, commencing when the initial spot month position limits for Referenced Contracts in Rule 151.4 are effective, for compliance with all aspects of the Position Limits Rule, including the spot-month position limits for *both* physical-delivery and cash-settled Referenced Contracts, in a manner that is consistent with the transition relief granted in Rule 20.10;

  - Permit netting in the spot-month between all economically equivalent Referenced Contracts, including physical-delivery and cash-settled Referenced Contracts;

  - Only require aggregation of positions in cash-settled Referenced Contracts based on common control because there is very little risk of excessive

speculation or manipulation in the markets for cash-settled Referenced Contracts;

- Clarify or expand the exemption for underwriting to apply to positions or accounts of an owned entity if the ownership interest is based on the acquisition or disposition of securities acquired in connection with the trading or market-making activities of a broker-dealer registered with the U.S. Securities Exchange Commission ("SEC"), or a comparable broker or dealer of securities in a non-U.S. jurisdiction; and

- Clarify that the "exemption for federal law information sharing restrictions" includes a *reasonable risk* of violating federal law, state law, or the law of a foreign jurisdiction; and restore a modified version of the "owned non-financial entity" exemption that was included in the initial proposal of the Position Limits Rule.

- The Commission should amend the definition of "swaption" and clarify the definition of the spot-month for cash-settled Referenced Contracts.

V. The Commission Should Withdraw the Interim Spot-Month Position Limits on Cash-Settled Referenced Contracts

As FIA explained in its October 1, 2010 pre-rulemaking comment letter and its March 25, 2011 comment letter filed in response to the Notice of Proposed Rulemaking, CEA Sections 4a(a)(2) and 4a(a)(5) expressly provide that before the Commission can establish limits "as appropriate" on speculative positions in Referenced Contracts, it must make separate findings pursuant to CEA Section 4a(a)(1) for *each* cash-settled and physical-delivery Referenced Contract that position limits are "necessary to diminish, eliminate or prevent" the burden on interstate commerce caused by excessive speculation.[12] Nevertheless, contrary to the plain language of CEA Section 4a(a), the Position Limits Rule imposes new spot-month position limits on the 28 Core Referenced Futures Contracts and all economically equivalent Referenced Contracts without the data required to make the statutorily required finding that any limits are "necessary" or to determine that the limit levels imposed by the Commission are "appropriate." The lack of essential data is particularly acute with respect to cash-settled Referenced Contracts because, as the Commission has noted in connection with the Large Trader Reporting for Physical Commodity Swaps final rule (the "Large Swap Trader Reporting Rule"), it did not start collecting large swap trader information for cleared swaps until more than a month after it issued

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[12] *See* Futures Industry Association, Comment Letter on Pre-Rulemaking Position Limit Comments and Recommendations at 4 (dated Oct. 4, 2010); Futures Industry Association, Comment Letter on Position Limits for Derivatives at 6 (dated Mar. 25, 2011).

the Position Limits Rule and has not yet even started to collect large swap trader information for bilateral uncleared swaps.[13]

In the Position Limits Rule, the Commission invites market participants to address whether the interim final rule best maximizes the four objectives in CEA Section 4a(a)(3)(B).[14] FIA respectfully submits that it does not. On the contrary, it is not even possible for the Commission to further the statutory objectives in CEA Section 4a(a)(3)(B) – ensuring sufficient market liquidity for *bona fide* hedgers and protecting the price discovery function of the underlying market – until the CFTC has adequate data regarding the markets for each Referenced Contract, including both physical-delivery *and* cash-settled contracts. Until the Commission has this information for the cash-settled Referenced Contracts, it should withdraw the Position Limits Rule, including the interim spot-month position limits.

With a single exception, the interim spot-month position limits do not even attempt to reflect the material differences that exist between the markets for physical-delivery and cash-settled Referenced Contracts.[15] Instead of analyzing data on futures and swaps positions (both cleared and uncleared) for each Referenced Contract, the Commission relies heavily on estimates of deliverable supply and the liquidity, price discovery function, and susceptibility to abuse of the *physical-delivery* Core Referenced Futures Contracts, and then uses these estimates to infer the supposed characteristics of the markets for each corresponding *cash-settled* Referenced Contracts. The Commission provides no empirical justification to support its assumption that the well-established physical-delivery markets and the newer (often larger) markets for cash-settled Referenced Contracts are essentially the same. This assumption is incorrect. FIA believes that the Commission will ultimately conclude, after it has collected and analyzed actual position data, that the markets for the physical-delivery and cash-settled Referenced Contracts differ materially.[16]

Although the Position Limits Rule considers cash-settled market activity that occurs on DCMs and exempt commercial markets, it does not separately analyze cash-settled over-the-

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[13] *See* Large Trader Reporting for Physical Commodity Swaps, 76 Fed. Reg. 43,851 (July 22, 2011); Letter from the Division of Market Oversight (granting temporary and conditional relief from certain Part 20 reporting requirements) (dated Nov. 18, 2011); Letter from the Division of Market Oversight (granting temporary and conditional relief from certain Part 20 reporting requirements) (dated Sept. 16, 2011).

[14] 76 Fed. Reg. at 71,638.

[15] The sole exception is the Commission's treatment of cash-settled natural gas Referenced Contracts. 76 Fed. Reg. at 71,636.

[16] As Commissioner O'Malia noted, "In aggrandizing a market condition that it has never defined through quantitative or qualitative criteria in order to justify draconian rules, the Commission not only fails to comply with Congressional intent, but misses an opportunity to determine and define the type and extent of speculation that is likely to cause sudden, unreasonable and/or unwarranted commodity price movements so that it can respond with rules that are reasonable and appropriate." 76 Fed. Reg. at 71,700.

counter swaps that are not cleared and not traded on an exchange – swaps that, nevertheless, will be subject to the Position Limits Rule. For example, the Commission's analysis of the market for West Texas Intermediate ("WTI") crude oil notes that, although it includes "an active cash-settled WTI futures contract (the cash-settled ICE Futures (Europe) West Texas Intermediate Light Sweet Crude Oil futures contract)," the ICE WTI contract has "an open interest of less than one-third that of the physical-delivery NYMEX Light Sweet Crude Oil futures contract" and that fewer than five traders typically hold large spot-month positions in this contract.[17] Then, without even mentioning the bilateral market for WTI crude oil swaps and options or other cash-settled Referenced Contracts that are economically equivalent to the NYMEX Light Sweet Crude Oil futures contract, the Commission summarily concludes that because "the size of the cash-settled swaps market involving WTI *does not appear* to be materially larger than that of the physical delivery Core Referenced Futures Contract, parity in spot-month limits between physical-delivery Core Referenced Futures Contracts and cash-settled contracts *should* ensure sufficient liquidity for *bona fide* in cash-settled contracts."[18]

As the Commission acknowledges in a related rulemaking and the preamble to *this* rule, the CFTC cannot evaluate the over-the-counter swaps markets because it currently has insufficient reliable data regarding the size of these markets or how they operate.[19] The CFTC has collected some swap position and related data from swap dealers, commodity index funds, and commodity index traders since June 2008 pursuant to a special call, but this data provides a view of the over-the-counter swaps markets that is far from complete. Since June 2008, the CFTC has collected through the special call limited information from swap dealers, commodity index funds, and commodity index traders:

- Swap dealers. Swap dealers must: (1) provide a classification of their index and single-commodity swaps businesses; (2) identify swaps clients holding all-months-combined futures equivalent positions greater than a single-month accountability level for the related market; and (3) provide data for bilateral single-commodity swaps by market and futures equivalent positions arising from swaps referenced or hedged in U.S. markets.
- Commodity index funds. Commodity index funds must: (1) provide a classification of their index swaps businesses; (2) provide their market exposure from holding futures positions and over-the-counter swaps or other derivatives positions; and (3) identify clients who have $100 million or more investment notional value.

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[17] 76 Fed. Reg. at 71,635.

[18] 76 Fed. Reg. at 71,635-36 (emphasis added).

[19] Large Trader Reporting for Physical Commodity Swaps, 76 Fed. Reg. 43,851 ("[w]ithout [Part 20], there would be no analogous reporting system in place for economically equivalent swaps"); 76 Fed. Reg. at 71,665 ("At present, the Commission has limited data concerning swaps transactions in Referenced Contracts (and market participants engaged in such transactions)."); *id.* at 71,668 n.411 (acknowledging "limited set of data it has on cleared swaps").

- Commodity index traders. Commodity index traders must provide the notional value of business based on commodities in the index in U.S. and non-U.S. markets and the estimated number of futures-equivalent contracts for each commodity traded on a DCM.

However, the data collected from the CFTC's June 2008 special call are incomplete and do not fully represent over-the-counter swaps markets in several important ways. In particular, the special call swap data: (1) were not collected from all relevant market participants; (2) do not include all swaps that fall within the definition of Referenced Contract; and (3) were reported as aggregate all-months-combined positions rather than individual, futures equivalent month positions across the forward curve. Moreover, because this information was reported by many market participants without a common methodology for standardizing position data, it is likely that positions were characterized differently by each reporting entity and not reported in sufficient detail to enable to Commission to analyze and correlate accurately all "economically equivalent" contracts.

The Commission has attempted to address these deficiencies by adopting the reporting requirements in Part 20 which require, among other things, standardized daily reports of all "reportable positions" in Referenced Contracts (both cleared and uncleared) from all clearing organizations, clearing members, and swap dealers.[20] However, as the Commission is aware, it has only just started to collect this information.[21] Moreover, until March 20, 2012, the Commission has authorized Division of Market Oversight to accept large swap trader reports pursuant to Part 20 in formats that differ from the requirements in the final rule. As a result, even under the most optimistic scenario, the Commission will not begin receiving reasonably complete and standardized data regarding the size and liquidity of the market for cash-settled Referenced Contracts until April 2012 at the earliest.

In contrast, by late 2012 or early 2013, the Commission will have nearly complete data that should enable it to conduct a disciplined and fact-based analysis of whether position limits on cash-settled Referenced Contracts are necessary and, if so, what levels are appropriate.[22]

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[20] *See* 76 Fed. Reg. at 71,665 ("The Commission should be able to obtain an expanded set of swaps data through its swaps large trader reporting and SDR regulations.").

[21] Notably, the Commission notes that even Part 20 will have significant limitations. The preamble to the Position Limits Rule states, "Part 20 reports will not provide data on positions where neither party to a swap is a clearing member or a swap dealer, but these positions represent a small fraction of all uncleared swaps. Since most uncleared swaps will be reportable under part 20, the Commission believes the swaps' data set will be adequate to set position limits." 76 Fed. Reg. at 71,632. The Commission should at least wait until it has basic information about the size and liquidity of markets it seeks to regulate before imposing position limits on cash-settled Referenced Contracts. Simply put, "administrative experience, available data, and trade interviews" are not an appropriate substitute for "adequate data." 76 Fed. Reg. at 71,635.

[22] 76 Fed. Reg. at 71,700 (As Commissioner O'Malia has stated, "[h]istorically, the Commission has taken a much more disciplined and fact-based approach in considering the question of position limits.").

Until the Commission receives this additional data, it has no factual basis for making the required finding that position limits for cash-settled Referenced Contracts are "necessary" to "diminish, eliminate, or prevent" manipulation or excessive speculation – or even that excessive speculation exists with respect to any given contract. Similarly, without this fundamental information, the Commission cannot determine at what level any position limits should be set, nor whether the interim final spot-month limits on cash-settled Referenced Contracts will: (1) diminish, eliminate, or prevent excessive speculation; (2) deter or prevent manipulation; (3) ensure sufficient market liquidity for *bona fide* hedgers; or (4) ensure that the price discovery function of the underlying markets is not disrupted.[23]

FIA respectfully submits that, as applied to cash-settled Referenced Contracts, the Position Limits Rule is premature, and based on a record that is incomplete and assumptions that are unsubstantiated. Accordingly, FIA recommends that the Commission withdraw the Position Limits Rule, including the interim spot-month position limits on cash-settled Referenced Contracts, until it has sufficient data to establish regulations that are necessary and appropriate.

VI. Any Spot-Month Position Limits on Cash-Settled Referenced Contracts Should be Higher and Less Restrictive than Comparable Limits for Physical-Delivery Core Referenced Futures Contracts

If the Commission declines to withdraw the interim spot-month position limits, then, at a minimum, it should modify the Position Limits Rule to establish higher and less restrictive position limits on cash-settled Referenced Contracts rather than mechanically imposing the same percentage of deliverable supply formula on different contracts linked only by a common underlying commodity. As the Commission noted in 1987, when it undertook a major review of its position limit regime, "[t]here are vast differences among the contracts for the same or similar commodities. Accordingly, it would appear inappropriate to set a single speculative position limit for all markets trading the same or similar commodities."[24] FIA agrees – the derivatives markets are diverse and cannot be accurately categorized based upon assumptions that lack a factual basis.

Spot-month position limits for cash-settled Referenced Contracts should not be automatically based on 25 percent of "the quantity of the commodity meeting a derivative contract's delivery specifications."[25] Rather, the Commission should take into account "the individual characteristics" of each Core Referenced Futures Contract, including the different settlement options — such as Exchange of Futures for Physicals, Exchange of Futures for Options, and Exchange of Futures for Swaps — available for each contract, in addition to the

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[23] 76 Fed. Reg. at 71,638; *see also* CEA Section 4a(a)(3)(B).

[24] Revision of Federal Speculative Position Limits, 52 Fed. Reg. 38,914, 38,917 (Oct. 20, 1987).

[25] 76 Fed. Reg. at 71,633.

size and liquidity of corresponding swaps markets (both cleared and uncleared) before setting spot-month position limits for cash-settled Referenced Contracts.[26]

The Commission asked whether it should use a higher ratio than one-to-one between physical-delivery and cash-settled contracts for some or all cash-settled contracts.[27] FIA respectfully submits that the Commission should set a higher ratio for cash-settled Referenced Contract in a manner that is consistent with its historical approach to determining whether position limits are "necessary" under CEA Section 4a(a)(1).[28] In particular, the Commission should consider:

- *Whether the Referenced Contract is cash-settled or requires delivery of the underlying commodity.* Historically, the Commission has explained that higher limits (or no limits at all) are appropriate for cash-settled contracts. For example, in Appendix B to Part 38 of its regulations, the Commission explains that "[i]n general, position limits are not necessary where the threat of excessive speculation or manipulation is nonexistent or very low."[29] Among the listed futures markets for which the Commission historically has not required a DCM to impose position limits are "contracts specifying cash settlement where the potential for distortion of [the contract's] price is negligible."[30] The Commission has not provided a reasonable

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[26] 76 Fed. Reg. at 71,634.

[27] 76 Fed. Reg. at 71,638.

[28] The Commission originally proposed substantially higher spot-month position limits on cash-settled Referenced Contracts, but eliminated them from the final version of the Position Limits Rule in response to concerns about the potential effect on liquidity in the markets for physical-delivery Referenced Contracts and based upon its unsubstantiated conclusion that without "parity" between the position limits for physical-delivery and cash-settled Referenced Contracts, the "limits would permit larger position[s] in lookalike cash-settled contracts that may provide an incentive to manipulate and undermine price discovery in the underlying physical-delivery contract." 76 Fed. Reg. at 71,635. FIA is not aware of any empirical evidence which supports a conclusion that higher limits (or no limits at all) on cash-settled Referenced Contract harms liquidity in related markets for physical-delivery Referenced Contracts. Indeed, the absence of position limits on cleared and OTC swaps prior to the recent amendments to the CEA did not have a negative effect on the liquidity physical-delivery Core Referenced Futures Contracts. Moreover, although "hammering the close" in one market in an attempt to benefit a larger, opposite position in another market may be, in some circumstances, a form of manipulation prohibited by the CEA, the fact that position limits are appropriately tailored to the economics of their respective markets and, therefore, not necessarily identical for physically-settled and cash-settled contracts does not, by itself, provide an "incentive" to engage in any form of illegal activity in either market.

[29] 17 C.F.R. § 38, Appendix B.

[30] *Id.*

explanation of why its prior finding that the potential for price distortion in cash-settled contracts is "negligible" no longer is valid.[31]

- *Whether speculative positions in a particular cash-settled Referenced Contract tend to be extraordinary in character and represent potentially abusive market power.* Historically, the Commission has only imposed speculative position limits on contracts where it has determined that there has been a tendency for significant speculative activity (or the potential for abusive market power). The Commission did not cite, and FIA is unaware of, any empirical evidence that speculative positions in cash-settled Referenced Contracts are extraordinary in character or represent a potential for abusive market power. On the contrary, the concepts of "excessive speculation" and abusive market power only apply imperfectly, if at all, to cash-settled contracts.

- *The size and distribution of speculative positions relative to the open interest in the cash-settled Referenced Contract.* Position limits are not necessary when speculative positions represent a small fraction of the overall open interest in a particular contract; however, the Commission will not have the data necessary to calculate the open interest in the cash-settled Referenced Contracts or the relative size and distribution of speculative positions until late 2012 at the earliest.

- *The size and distribution of hedge positions relative to the open interest in the cash-settled Referenced Contract.* Position limits are not necessary when hedge positions represent a significant portion of open interest and are well-distributed across the forward curve. However, as noted above, the Commission will not have the data necessary to calculate the open interest in the cash-settled Referenced Contracts or the relative size and distribution of hedge positions until late 2012 at the earliest.

- *Possible anti-competitive effects that might result from the imposition of position limits.* Position limits are not appropriate when they may result in inappropriate information sharing between market participants or other anti-competitive effects. Although the Position Limits Rule provides limited relief for violations of federal information sharing restriction laws, as discussed below, the Commission has not adequately considered the potential anti-competitive effects that might result from imposing position limits on cash-settled Referenced Contracts where sharing information among affiliated entities, such as parties to a joint venture, may not unambiguously violate federal or state law.

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[31] *FCC v. Fox Television Stations, Inc.*, 129 S. Ct. 1800, 1811 (2009) (an agency seeking to depart from prior established policy must explain the change, "provid[ing] a more detailed justification than what would suffice for a new policy created on a blank slate").

- *Whether arbitrage exists to an appreciable degree between the cash, futures, and swaps markets and, thus, limits the potential for a large position to influence price.* Although the markets for physical-delivery and cash-settled Referenced Contracts are separate and distinct, these markets often are closely correlated. However, as noted above, the Commission will not have the data necessary to accurately assess whether sufficient arbitrage exists between the various markets for commodities and derivatives to limit the potential for a large position in one market to influence prices in a related market until late 2012 at the earliest.

FIA believes that, after the Commission applies these criteria to the cash-settled Referenced Contracts, it will determine that the available data support *no* position limits for cash-settled contracts, and that in any event, position limits for cash-settled contracts are especially inappropriate if not set at a substantially higher level (or at a much higher percentage of the deliverable supply) than for physical-delivery contracts. By waiting to set position limits until after it has the necessary data (or setting positions at a sufficiently high level to avoid potential harm) the Commission will ensure that it is exercising its regulatory responsibilities in a manner that is consistent with statutory objectives in CEA Section 4a(a).[32]

FIA believes that, if interim spot-month position limits on cash-settled Referenced Contracts in the Position Limits Rule are to be adopted despite the lack of any evidence that *any* position limits are necessary, a deliberate and incremental approach is essential to ensuring that the efficiency, competitiveness, and financial integrity of the markets, including their price discovery and risk management functions, are not disrupted. A precautionary approach to the Position Limits Rule, particularly for the cash-settled Referenced Contracts, is less likely to harm the U.S. derivatives markets. As former Commissioner Dunn warned before voting in favor of the rule, "position limits [are] at best a cure for a disease that does not exist or a placebo for one that does. At worst, position limits may harm the very markets [the CFTC is] intending to protect."[33] To reduce this harm, FIA urges the Commission to take great care to ensure that its regulations remain sufficiently flexible. FIA recommends that the Commission delegate to the Director of the Division of Market Oversight the authority to specify higher limits "as appropriate" for each cash-settled Referenced Contract. Regulations that unnecessarily or inappropriately restrict the risk management and price discovery function of the U.S. derivatives markets will, contrary to the requirements of the CEA and good public policy, ultimately harm market participants and the public, along with the efficiency, competitiveness, and integrity of the financial markets as a whole.

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[32] CEA Section 4a(a).

[33] Opening Statement of Commissioner Michael Dunn, CFTC Public Meeting (Oct. 18, 2011).

VII. The Commission Should Provide a Six-Month Safe Harbor Transition Period for Compliance with All Aspects of the Position Limits Rule

If the Commission declines to withdraw the interim spot-month position limits, then it should provide a safe harbor transition period in a manner that is consistent with the transition relief granted in Rule 20.10.[34] This safe harbor transition period should extend for no less than six calendar months from the date that the initial spot month position limits for Referenced Contracts in Rule 151.4 are effective (*i.e.*, six calendar months following 60 days after the further definition of "swap" is published in the Federal Register) and should include compliance with all aspects of the Position Limits Rule, including the spot-month position limits for both physical-delivery and cash-settled Referenced Contracts, conditioned only on the obligation that an entity relying on such relief is making a good faith attempt to comply with the provisions of the Position Limits Rule. A six-month safe harbor transition period will provide essential time and flexibility to ensure that: (1) the Staff has sufficient time to provide market participants with much needed guidance about unclear aspects of the new regulations; and (2) market participants will be able to come into compliance with the rules in the most complete and economical manner possible. As the Commission is aware from its experience implementing the Large Swap Trader Reporting Rule, without some form of transition relief, CFTC Staff may be overwhelmed by questions from market participants seeking clarification on a wide range of substantive and technical questions. If these questions cannot be resolved before full compliance is required, many market participants may inadvertently violate the Position Limits Rule, despite expending substantial time and money to avoid that result. FIA believes that a six-month safe harbor will reduce the risk of this counterproductive, but easily avoided outcome.

VIII. The Commission Should Permit Netting Between all Economically Equivalent Referenced Contracts in the Spot-Month

If the Commission does not withdraw the interim spot-month position limits on cash-settled Referenced Contracts, it should permit netting between positions in physical-delivery and cash-settled Referenced Contracts in the spot-month. As FIA explained in its October 1, 2010 pre-rulemaking comment letter and its March 25, 2011 comment letter filed in response to the Notice of Proposed Rulemaking, CEA Section 4a(b) makes it a violation for any person to "hold or control a *net long or short* position, . . . in excess of any position limit fixed by the Commission."[35] Although CEA Section 4a(a)(1) provides the Commission with the authority to establish different limits for "different . . . markets," CEA Sections 4a(a)(5) and (6) emphasize the importance of aggregate limits on all economically equivalent positions, including physical-

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[34] *See* 17 C.F.R. § 20.10.

[35] *See* CEA Section 4a(b) (emphasis added); Futures Industry Association, Comment Letter on Pre-Rulemaking Position Limit Comments and Recommendations on Oct. 1, 2010, at 4; Futures Industry Association, Comment Letter on Position Limits for Derivatives on Mar. 25, 2011, at 6.

delivery and cash-settled Referenced Contracts.[36] Aggregate limits reflect a trader's actual exposure and, therefore, true position for determining compliance with position limits. The Commission should not artificially restrict the ability of market participants to manage their risk in the most efficient and responsible manner possible by restricting the netting of economically equivalent positions in Referenced Contracts in the spot-month.[37]

IX. The Commission Should Only Require Aggregation of Positions in Cash-Settled Referenced Contracts Based on Common Control

The Commission should not require market participants to aggregate commonly-owned positions in cash-settled Referenced Contracts when the positions of two entities are not subject to common control. Requiring aggregation of all positions in Referenced Contracts held by entities that share ten percent or greater common ownership (regardless of actual control) will substantially disrupt the efficient operation of numerous businesses, including many companies that have deliberately established information barriers and separate organizational structures to *prevent* joint ventures and other affiliates from sharing potentially sensitive position and trading information. Moreover, requiring aggregation of all commonly held positions in Referenced Contracts would create new compliance issues, while potentially harming market liquidity and the competitiveness of the market as a whole.

Nevertheless, if the Commission retains a broad aggregation requirement for all commonly held Referenced Contracts, regardless of the risks they pose, it should amend the aggregation exemptions to reduce unnecessary and unanticipated adverse consequences by:

- Clarifying or expanding the exemption in Rule 151.7(g) to include positions or accounts of an owned entity if the ownership interest is based on the acquisition or disposition of securities acquired in connection with the trading or market making

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[36] *See* CEA Section 4a(a)(5) ("the Commission shall establish limits on the amount of positions, including aggregate position limits, as appropriate, other than bona fide hedge positions, that may be held by any person with respect to swaps that are economically equivalent to contracts of sale for future delivery . . ."); CEA Section 4a(a)(6) ("The Commission shall . . . establish limits (including related hedge exemption provisions) on the aggregate number or amount of positions in contracts based upon the same underlying commodity . . .").

[37] The Commission suggests that if netting were permitted in the spot month, "a trader could stand for 100 percent of deliverable supply . . . by holding a large long position in the physical-delivery contract along with an offsetting short position in a cash-settled market, which effectively would corner the market." 76 Fed. Reg. at 71,637. This has not happened before the Commission imposed position limits on swaps when traders could hold offsetting positions in physical delivery and cash-settled contracts (*i.e.*, a "flat book") and is highly unlikely to occur under any reasonable scenario in the future. The substantial penalties under the CEA for manipulation and attempted manipulation, in addition to the "surveillance system [which] serves to detect and prevent market manipulation, squeezes, and corners in the physical-delivery futures contracts as well as market abuses in cash-settled contracts," make a blatant corner or squeeze of any commodity market unlikely. 76 Fed. Reg. at 71,637.

activities of a broker-dealer registered with the SEC, or a comparable broker or dealer of securities in a non-U.S. jurisdiction;

- Expanding the exemption in Rule 151.7(i) for "federal law information sharing restriction" to include a *reasonable risk* of violating federal law;
- Expanding the exemption in Rule 151.7(i) to include a *reasonable risk* of violating state law or the law of a foreign jurisdiction; and
- Reinstating a modified version of the "owned non-financial entity" exemption from the proposed version of the Position Limits Rule that allows all market participants to disaggregate positions in Referenced Contracts held by commercial entities that are independently managed and controlled.

1. *The Commission should clarify or expand the exemption for underwriting to include positions or accounts of an owned entity if the ownership interest is based on certain acquisitions and dispositions of securities.*

The Commission should clarify or expand the exemption in Rule 151.7(g) for underwriting activity to include situations where a broker-dealer acquires a greater than ten percent ownership interest in another entity in the secondary market in anticipation of demand, as part of its normal market-making activity, or as a result of a routine life cycle event (*e.g.*, a stock distribution). As with traditional underwriting activities, these situations do not present the same concerns of sharing transaction or position information that may facilitate coordinated trading. On the contrary, unlike a long-term investment in a new affiliate where a company may acquire an ownership interest with a reasonable expectation that the two businesses will, directly or indirectly, collaborate in the future, holding a passive and temporary position in another company as part of a financial entity's trading business does not provide even a theoretical basis to suppose that excessive speculation or manipulative activity will occur, even if those positions are relatively large. An interpretation of the Position Limit Rule that would require aggregation of *all* entities with ten percent or more common ownership will make many forms of institutional securities trading and market-making impracticable, thereby reducing the liquidity and efficiency of the securities markets. FIA believes that this would be an unnecessary and unintended result the costs of which would greatly exceed any possible benefits.

2. *The Commission should expand the exemption for "federal law information sharing restriction" to include a reasonable risk of violating federal law, state law, or the law of a foreign jurisdiction.*

The Commission should expand the exemption in Rule 151.7(i) for "federal law information sharing restriction" to include a *reasonable risk* of violating federal law. In addition, the Commission should expand the exemption in Rule 151.7(i) to include a reasonable risk of violating *state law and the law of a foreign jurisdiction*. Without these clarifications, market

participants could be required either: (1) to share information with another entity under circumstances that increase their potential legal risk; or (2) to refrain from otherwise legitimate market activity that reduces risk and increases market liquidity.

For example, under the Position Limits Rule, a joint venture of which at least ten percent is owned by each of two competitors would be required to aggregate its positions in Referenced Contracts with any positions held by each of the competitors unless an exemption from aggregation applies. Federal (and in some cases state) anti-trust laws prohibit competitors from sharing information under certain circumstances, but the applicable legal standards often require application of a rule of reason standard, are subjective, and depend on the facts of each case. Moreover, competitors engaged in joint ventures often sign non-disclosure agreements that establish duties to keep certain commercial information segregated and confidential, but it is not necessarily clear whether regulatory reporting obligations preempt these competing obligations to keep information confidential.

To comply with the Position Limits Rule, the two competitors would need access to the joint venture's Referenced Contract and cash market position information on a real-time basis, including, for positions that exceed an applicable limit, details on how the purchases and sales of Referenced Contracts are "economically appropriate" to the reduction of the risks being hedged. This communication *could* violate federal law, as well as possibly state law (*e.g.*, fiduciary duties) or the laws of a foreign jurisdiction (*e.g.*, privacy laws), in addition to any non-disclosure agreement entered into by the parties, but it *may not* fall within a literal interpretation of the "exemption for federal law information sharing restrictions" in Rule 151.7(i). As a result, to avoid inadvertently violating the Position Limits Rule, the entities described above would be required to allocate artificially the applicable position limits among the aggregated entities (which could be commercially impracticable if either entity is part of a larger, highly integrated commercial organization) and risk violating antitrust laws, or force the joint venture to cease trading in all Referenced Contracts (which if it results in the joint venture operating un-hedged, would be commercially imprudent). FIA does not believe that the Commission intended for the Position Limits Rule to lead to such an impractical result.

3. *The Commission should reinstate a modified version of the "owned non-financial entity" exemption from the proposed version of the Position Limits Rule that allows all market participants to disaggregate positions in Referenced Contracts held by commercial entities that are independently managed and controlled.*

The Commission should reinstate a modified version of the "owned non-financial entity" exemption from the proposed version of the Position Limits Rule that allows all market participants to disaggregate the positions in Referenced Contracts held by commercial entities

that are independently managed and controlled.[38] As the Commission explained in the preamble to the Position Limits Rule, "[t]he fundamental rationale for the aggregation of positions or accounts is the concern that a single trader, through common ownership or control of multiple accounts, may establish positions in excess of the position limits and thereby increase the risk of market manipulation or disruption."[39] However, in situations where there is no common control (notwithstanding a ten percent or more common ownership), there is *no risk* of coordinated trading, therefore, the public policy rationale for aggregation no longer applies.

Although the Commission stated that the disaggregation exemptions in the Position Limits Rule "[were] appropriately limited to situations that do not present the same concerns as those underlying the aggregation policy, namely, the sharing of transaction or position information that may facilitate coordinated trading," it removed the exemption for owned non-financial entities from the final rule without providing advance notice to market participants and based on a conclusion that is factually incorrect.[40] Without this exemption, market participants will be required to aggregate *all* positions in Referenced Contracts, including cash-settled Referenced Contracts, held by any entity in which it shares ten percent or greater common ownership, even if such investment is entirely passive and both entities are subject to independent management and control. Such a result will have an unnecessary and profoundly negative impact on users of Referenced Contracts, and their affiliates with no corresponding benefit to the stability or integrity of the market.

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[38] As FIA explained in its March 25, 2011 comment letter, the Commission should modify the "owned non-financial entity" exemption in two important ways: (1) it should make the exemption conditionally effective upon filing; and (2) it should not rely solely on fixed indicia of control when determining whether two entities are subject to common control. *See* Futures Industry Association, Comment Letter on Position Limits for Derivatives at 23-27 (dated Mar. 25, 2011). A self-effectuating exemption would eliminate potential uncertainty and compliance questions that will almost certainly result if the CFTC is required to act upon the disaggregation requests submitted by all commonly owned, but independently managed and controlled, entities *before* the compliance date of the Position Limits Rule. Similarly, a flexible approach for determining whether two entities are subject to common control will avoid unnecessary restrictions for entities that are able to demonstrate independent management and control through criteria not specifically enumerated in the CFTC's regulations.

[39] 76 Fed. Reg. at 71,652.

[40] 76 Fed. Reg. at 71,654. The preamble to the Position Limits Rule states that, "[i]n view of the Commission's determination to retain the IAC exemption and the aggregation policy in general (which the Commission believes has worked effectively to date), provide an exemption for Federal law information sharing restrictions in final § 151.7(i) and provide an exemption for underwriting in final § 151.7(g), the Commission believes that it would not be appropriate, at this time, to expand further the scope of disaggregation exemptions to owned non-financial or financial entities. As described above, *the final rules include express disaggregation exemptions to mitigate the impact of the aggregation requirements that apply to commonly owned entities or accounts*. . . . [therefore,] the Commission does not believe further expansion of the disaggregation exemptions is warranted at this time." *Id.* Although the Position Limits Rule recognizes several exemptions from the aggregation requirement, significantly, the IAC exemption *does not apply* to independently managed and controlled, but commonly owned non-financial entities.

X. The Commission Should Reexamine the Costs and Benefits Associated with Imposing Spot-Month Position Limits on Cash-Settled Referenced Contracts

The Commission also invited comments on the costs and benefits considerations under CEA Section 15a.[41] FIA respectfully submits that the Commission's consideration of the costs and benefits of the Position Limits Rule is insufficient and based upon estimates that are unrealistically low in terms of time, money, and adverse effects on market participants.

The Commission estimated that "trading firms that currently track compliance with DCM or Commission position limits will incur an additional labor cost of two or three labor weeks in order to adjust their monitoring systems to track the position limits for Referenced Contracts."[42] Similarly, the Commission estimated that the implementation and monitoring costs for each of approximately 100 "swaps-only" firms would range "from 40 to 1000 annual labor hours [or] $5,000 to $100,000 in total annualized capital/start-up costs, and $1,000 to $20,000 in annual operating and maintenance costs."[43] These estimates are materially too low and wholly disregard the potentially enormous cost that all companies subject to the Position Limits Rule must incur to document, verify, and track *each* Referenced Contract (including bilateral swaps that have never been subject to standardized reporting) on an individual and continuous basis to determine whether it falls within one of the eight enumerated hedging categories or is below the applicable speculative position limit.

FIA believes that the actual cost for market participants to comply with the Position Limits Rule will be materially higher than the Commission estimates. Because of the complexity and unprecedented nature of the Position Limits Rule and its interplay with other existing and evolving regulatory requirements, FIA members are not able to provide precise cost estimates for implementation of, and ongoing compliance with, the Position Limits Rule. However, based on their compliance experience with position limits and reporting for futures, and their recent experience implementing the requirements of the Large Swap Trader Reporting Rule and Position Limits Rule, some FIA members estimate that the *per entity* costs attributable to the following efforts very likely could be:

- As high as $4 to $8 million for general implementation and initial compliance to build, implement, and refine new information technology systems needed to monitor positions in all Referenced Contracts (including swaps) on an aggregate, real-time basis; and

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[41] 76 Fed. Reg. at 71,638.

[42] 76 Fed. Reg. at 71,666. According to the Commission, "[a]ssuming an hourly wage of $78.61, multiplied by 120 hours, this implementation cost would amount to approximately $12,300 per firm, for a total across all estimated participants affected by such limits . . . of $4.2 million." *Id.*

[43] 76 Fed. Reg. at 71,667.

- For a large conglomerate, at least: (1) as high as $500,000 to $1 million to identify all entities subject to aggregation and to establish protocols for reporting all commonly owned and controlled positions in Referenced Contracts; (2) $1 to $1.5 million to establish new information technology systems for consolidating and tracking aggregated position information; and (3) $100,000 for each entity subject to aggregation to report position information to its affiliates (and/or controlling entities).

Notably, the majority of these estimates *exclude* the costs of preparing and filing exemption notices, and ongoing costs that must be incurred on a continuous basis to employ the required personnel and to maintain the new systems required to comply with the Position Limits Rule. These estimates also do not reflect the increased risk than an entity may be subject to a government enforcement action for an inadvertent violation the Position Limits Rule caused by an unavoidable technological failure or innocent implementation error.[44]

Furthermore, these estimates do not quantify the large costs and inefficiencies the Position Limits Rule will impose upon the markets, and the entire range of market participants. For example, because the Position Limits Rule narrows the statutory definition of *bona fide* hedging in ways that are inconsistent with long-standing commercial risk management practices, particularly in the spot-month, commercial entities may be forced to incur additional risks and dealers will have substantially less capacity to accommodate customer business. In order to guarantee that they remains within applicable limits on an aggregate basis, entities subject to the Position Limits Rule may be forced to divest certain assets and ownership interests, discontinue certain lines of business, change existing trading strategies, and terminate relationships with both new and established customers. These harms will be irreversible.

FIA also is concerned about the cost of implementing the Position Limits Rule because the Commission's estimates for implementing the Large Swap Trader Reporting Rule, which is much less complex and applies to a smaller universe of market participants than the Position Limits Rule, have proven to be materially incorrect.[45] The Commission's consideration of the costs and benefits of the Large Swap Trader Reporting Rule closely resembles the estimates in

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[44] As the Commission is aware, the cost of defending an allegation of a regulatory violation can be substantial, both in terms of time and money. This is particularly true for new and complicated rules, such as the Position Limits Rules, where the appropriate legal standard is not well-established and objectively defined.

[45] The Commission was similarly incorrect that the costs of implementing new compliance systems would be relatively small for firms already subject to DCM-set limits. *See*, *e.g.*, 76 Fed. Reg. at 71,699 ("All of the 28 Core Referenced Futures Contracts have some form of spot-month position limits currently in place by their respective DCMs, and thus market participants with very large positions (at least those whose primary activity is in futures and options markets) should be currently incurring costs (or foregoing benefits) associated with those limits."). Bilateral swaps have never been subject to position limits. Moreover, because bilateral swaps are not traded on exchanges, categorizing and tracking these contracts requires new, sophisticated systems that have little in common with the systems in place to track futures positions.

Position Limits Rule both in terms of the depth of the analysis and the ultimate conclusions.[46] For example, the Commission estimated that it would cost non-clearing member swap dealers, on average, $105,000 per year to comply with the reporting and recordkeeping requirements associated with the Large Swap Trader Reporting Rule.[47]

As market participants have started to implement and refine the systems needed to comply with the specific requirements of the Large Swap Trader Reporting Rule, they routinely have been required to spend much more time and more money than the Commission initially projected. Indeed, the Commission should take Official Notice of its own records concerning the many inconsistencies between the rule text and actual records of transactions, positions and parties, the scores, if not hundreds, of calls and meetings between reporting entities and Commission Staff, the hundreds of questions raised by market participants, the multiple drafts of a 172-page Guidebook (released only a few days before the first reports were due), the questions raised by Commission Staff about reports filed to-date by clearing organizations and clearing members, the time and effort devoted by Commission Staff to implementation, and the need for a six-month, conditional transition period to come into compliance with the Large Swap Trader Reporting Rule, to see that its cost-benefit analysis for that substantially less complex rule was unrealistically low. FIA has little doubt that the Commission's estimated cost of implementation and compliance with the Position Limits Rule is off by an equal, if not greater, order of magnitude. As a result, FIA respectfully submits that the Commission has underestimated the burden associated with this regulation by thousands of man-hours and hundreds of millions of dollars.

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[46] Although the Large Swap Trader Reporting Rule and the Position Limits Rule are related, the costs associated with implementing and complying with each rule is almost entirely distinct. The Position Limit Rule requires entities to design and implement systems to classify and monitor positions including, among other things, whether a position is a *bona fide* hedge (and if so, what type), whether a contract is qualifies as a pass-through-swap (or a pass-through-swap offset), and whether an entity's positions exceed a position limit or visibility level when calculated on an aggregate, real-time basis. None of these issues are implicated, directly or indirectly, by the Large Swap Trader Reporting Rule.

[47] 76 Fed. Reg. at 43,859 ($80,000 or 375 hours per entity for reporting, $20,000 or 20 hours for recordkeeping, and $5,000 or 9 hours for 102S submissions). Notably, although FIA commented in response to the proposed version of Large Swap Trader Reporting Rule that some of its members believed the costs associated with complying with Large Swap Trader Reporting Rule could be "very substantial and in some cases exceeding millions of dollars," the Commission determined that its initial estimates were "reasonable and satisfactory in accordance with CEA Section 15(a)(2)."

XI. The Commission Should Amend and Clarify Important Definitions in the Position Limits Rule.

A. The Commission Should Amend the Definition of Swaption

The Position Limits Rule defines "swaption" as including "a physical commodity option."[48] This definition is inconsistent with the definition of the same term in the Large Swap Trader Reporting Rule. When the Commission issued the proposed version Large Swap Trader Reporting Rule, it proposed a definition of swaption that, like the Position Limits Rule, included physical commodity options.[49] However, when it issued the final version of the Large Swap Trader Reporting Rule, it limited the definition of "swaption" to "an option to enter into a swap or a swap that is an option."[50] The Commission similarly should delete the reference to physical options from the definition of swaption in the Position Limits Rule. The Commission should take Official Notice of the comments submitted in response to the proposed product definitions by many market participants who explained that the Commission should not regulate physical commodity options as swaps because they are fundamentally different transactions which the Commission has separate authority to regulate and which involve all of the issues associated with physical delivery. Subjecting physical commodity options to position limits with no finding that such limits are necessary and with no explanation for their disparate treatment under related Commission regulations will exponentially increase the burden of complying with an already overly complex rule.

B. The Commission Should Clarify the Definition of Spot Month for Cash-Settled Referenced Contracts

The definition of spot month for Referenced Contracts in Rule 151.3 varies by type of commodity and is tied to the DCM definition of spot-month for the relevant physical delivery contract.[51] Those definitions create a number of ambiguities and incongruous results when applied to cash-settled Reference Contracts. For example, the definition of spot month for the NYMEX Henry Hub Natural Gas Core Referenced Futures Contract extends past the expiration of the contract though the end of the delivery period *in the following calendar month*.[52] However, a market participant will not have an open NYMEX Henry Hub Natural Gas futures contract after the last day of trading of the relevant futures contract. Nevertheless, the same

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48 17 C.F.R. § 151.1.

49 17 C.F.R. § 20.1 (defining a "swaption" as "an option to enter into a swap or a physical commodity option included in the definition of "swap" under section 1a of the Act and any Commission definitional regulations adopted thereunder.").

50 *Id.*

51 17 C.F.R. § 151.3; 76 Fed. Reg. at 71,686

52 17 C.F.R. § 151.3(c).

market participant may have a position in a Referenced Contract that is priced based upon an index other than the NYMEX Henry Hub Natural Gas contract (*i.e.*, a swap that is priced based upon the price of natural gas for delivery at Henry Hub, but not based upon the NYMEX Henry Hub Natural Gas contract settlement price) that remains open past the last day of trading of the Core Referenced Futures Contract. Once the Core Referenced Futures Contract expires, even a large swap position cannot have any effect on the settlement price of the futures contract. Thus, there does not seem to be any sound basis for extending the spot month for cash-settled Referenced Contracts beyond the last day of trading of the liked futures contract for position limit purposes. The current broad definition of spot month, particularly as applied to cash-settled Referenced Contracts, renders the interim final spot-month limits ambiguous and overly complex.

XII. Conclusion

For the foregoing reasons, FIA respectfully requests that the Commission withdraw the Position Limits Rule until after it has collected and analyzed the information it needs to determine whether position limits for cash-settled Referenced Contracts are "necessary," and if so, whether any limits that it sets are "appropriate." In the alternative, FIA requests that the Commission adopt FIA's recommended revisions to the Position Limits Rule before issuing final position limits for cash-settled Referenced Contracts.

Please direct any questions about FIA's comments and recommendations to Barbara Wierzynski, Executive Vice President and General Counsel, at 202-466-5460.

Respectfully yours,

John M. Damgard
President

cc: Honorable Gary Gensler, Chairman
Honorable Jill E. Sommers, Commissioner
Honorable Bart Chilton, Commissioner
Honorable Scott O'Malia, Commissioner
Honorable Mark P. Wetjen, Commissioner
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