April 16, 2012

David A. Stawick
Secretary, Commodity Futures Trading Commission
3 Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: "Prohibitions and Restrictions on Proprietary Trading and Certain Interest in, and Relationships With, Hedge Funds and Covered Funds," a/k/a "The Volcker Rule," 77 *Fed. Reg.* 8332, RIN 3038-AD05 (Feb. 14, 2012).

Dear Mr. Stawick:

The Petroleum Marketers Association of America ("PMAA") and the New England Fuel Institute ("NEFI") appreciate the opportunity to submit this letter to the Commodity Futures Trading Commission ("CFTC" or "Commission") in response to the Notice of Proposed Rulemaking ("NPR") on "Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Covered Funds," also known as the "Volcker Rule."

**About Us**

PMAA is a national federation of 48 state and regional trade associations representing over 8,000 independent petroleum marketing companies. These companies own 60,000 convenience store/gasoline stations and supply motor fuels, including gasoline and diesel fuel, to an additional 40,000 stores. PMAA member companies also sell at retail 90 percent of the home heating oil consumed in the United States.

Joining PMAA in these comments is the New England Fuel Institute ("NEFI"). NEFI is a member of PMAA and an independent trade association representing approximately 1,200 home heating businesses including heating oil, kerosene and propane dealers and related services companies, most of which are small, multi-generational family owned- and operated-businesses. Many PMAA and NEFI members also market lubricants, jet fuels and racing fuels, as well as renewable fuels such as biofuels and other alternative energy products.

Many of our members engage in hedging activities to protect their businesses and consumers from price risk, or otherwise rely on these markets as a benchmark for commodity prices that are reflective of supply and demand fundamentals. They rely on regulators to ensure that these markets are transparent, stable and regulated, and free from fraud, manipulative or disruptive trading practices and excessive speculation. We consider the full and vigorous implementation and enforcement of a strong "Volcker Rule" to be vital in meeting these goals.

## Introduction

Federal regulators are required to implement the new rule, required under Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act" or the "Act") , by July 21, 2012.[1] The law requires that the CFTC work with the Securities and Exchange Commission, the Federal Reserve, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation ("the Agencies") in promulgating a final rule. Again, we appreciate that the Commission and the Agencies are working together in such an open and transparent manner to allow adequate public review of the proposed rule and to solicit comments on how it should be strengthened, implemented and enforced.

Congress enacted the Volcker Rule in response to the prominent role played by proprietary trading in the run-up to and eventual collapse of the financial markets in 2008. Lawmakers sought to to prohibit the misuse of taxpayer-backed loans and customer deposits in risky proprietary trading activities. The goal was to bring back important protections afforded by the Glass-Steagall Act of 1932, which for nearly 70 years prevented the misuse of federally-insured deposits in risky investment bank activities. The Glass-Steagall Act, however, was repealed by Congress in 1999.[2]

In reestablishing new prohibitions on proprietary trading, is important to note that the provision's Congressional authors clearly expected federal regulators to take a broad view when determining covered financial entities, trading practices and instruments. The Commission will note that Congress explicitly intended for commodity futures and related markets to be included in the ban on proprietary trading.[3] NEFI and PMAA strongly urge against the exclusion of commodities futures, options and swaps and related activities from prohibitions on proprietary trading. Of note, Section 619(h)(4) of the Act explicitly lays out Congressional intent that commodities be included in the definition of proprietary trading (emphasis added):

> "(4) PROPRIETARY TRADING – The term 'proprietary trading' when used with respect to a banking entity or nonbank financial company supervised by the Board, means engaging as a principle for the trading account of the banking entity or nonbank financial company supervised by the Board in any transaction to purchase or sell, or otherwise acquire or dispose of, any security, any derivative**, any contract of sale of a commodity for future delivery**, any option on any such security, derivative, or contract, or any other security or financial instrument that the appropriate Federal banking agencies, the Securities and Exchange Commission, and the [CFTC] may, by rule as provided in subsection (b)(2), determine."

The statutory definition clearly instructs the Commission and the Agencies to include all commodity futures and forwards, and derivatives of such contracts including options and swaps.

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[1] Pub.L. 111-203, Section 619 (codified at 12 U.S.C.1851).

[2] Referenced protections under the Glass-Steagall Act (Pub.L.73-66) were repealed by the Gramm-Leach Bliley Act of 1999 (Pub.L.106-102).

[3] 156 CR S5895 (Jul 15, 2010) setting forth the intent of the Merkley-Levin provisions, which include Section 619, stating clearly the "definition of proprietary trading …covers a wide range of financial instruments, including securities, commodities, futures, options, derivatives and any similar financial instruments."

However, it is extremely important that this definition include speculative trading or other risky financial activities in spot commodities, which as the Commission noted and we observe is conspicuously absent from the proposed rule.[4] We are concerned that the exemption of certain trading strategies and financial instruments could result in regulatory arbitrage and open the door to the migration of proprietary trading to those areas. This may jeopardize otherwise well-functioning markets, including spot markets.

We reject a recent Morgan-Stanley commissioned report that claims that implementation of the proposed Volcker Rule will lead to adverse impacts on the energy markets, such as higher prices and even refinery closures.[5] The report argues that there would be a loss of liquidity that would result in "increased price volatility for energy commodities, wider bid-ask spreads, reduced access to services and increases basis risk for hedging strategies." An analysis of the report has called it "hatchet job" that makes "ridiculous" assumptions.[6] John Parsons of the Center for Energy and Environmental Policy Research a the Massachusetts Institute of Technology states that the report incorrectly assumes that only large banks can provide the kinds of services they argue would be jeopardized by prohibitions on proprietary trading. Yet, the report provides no evidence proving this assumption. The reality is that there are a number of non-banks that are already providing many of the services for which large banks seek a continued monopoly. Further, as is correctly pointed out by Parsons, the Volcker Rule does not eliminate proprietary trading. It "simply says that the proprietary trading desks …should be separate from the banks." He rightly faults the report for assuming its own conclusion.

This report is part a long-running effort by Wall Street to water-down, delay or repeal new regulation and federal oversight of currently lucrative and non-competitive trading activities by alleging potential harms to liquidity and risk mitigation (i.e., hedging). While it is vital that federal regulators consider carefully the effects on *bona fide* hedgers, end-users and consumers, we do not believe that federal policy should be driven by sensational and unsubstantiated claims of surging prices and market collapse. We also object when financial firms seek hedging exemptions not for the purpose of protecting legitimate risk-mitigation practices from undue regulation, but rather to evade federal oversight and preserve market dominance.

Ultimately, the Commission and the Agencies must acknowledge that commodity speculation is a highly-leveraged, risk-permeated activity and therefore should not be conducted through the use of federally-insured deposits or taxpayer subsidies. Congress was wrong to have repealed the Glass-Steagall Act's separation of commercial banking activities and risky investment practices, as it was wrong to deregulate the commodities markets under the Commodity Futures Modernization Act of 2000. The Volcker Rule is yet another important step in the long process of healing these wounds and restoring some semblance of market stability and consumer confidence in the commodity derivatives markets.

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[4] See footnote 4, above. Section ___.3 of the proposed rule does not include positions in spot commodities.

[5] *The Volker Rule: Impact on the U.S. Energy Industry and Economy*, IHS, March 28, 2012.

[6] Parsons, John E., "The Quickest Way to A Conclusion … Jump," *Betting the Business*, March 28, 2012, online at: http://bettingthebusiness.com/2012/03/28/the-quickest-way-to-a-conclusion-jump/#more-1439 (accessed April 16, 2012).

## Comments

NEFI and PMAA support the timely, comprehensive and vigorous implementation of a final Volcker Rule that focuses on consumer protection, market stability and systemic risk prevention and that seeks to restrain the harmful effects of reckless speculation on consumers, businesses and the broader economy. We ask that the Commission consider the following comments on how the proposed Volcker Rule might be further strengthened to more fully comply with Congressional intent.

### 1. Preventing Systemic Risk

The most frequently-cited reason for meaningful prohibitions on proprietary trading is prevention of the sort of risky activities that broke the back of the global financial system and created systemic weaknesses that ultimately lead to the market collapse in 2008. In addition to other measures that seek to prevent systemic risk, such as mandatory clearing requirements, Congress included the "Volcker Rule" in the Dodd-Frank Act to reestablish a regulatory barrier between commercial banking activities and risky investment practices. The reason for its inclusion was to prohibit federally insured deposits from being misused in "gambling-like" speculative trading practices. These issues are thoroughly examined in comments submitted by the *Americans for Financial Reform* and we strongly encourage the CFTC and the Agencies to incorporate their recommendations into a final rule.[7] We would also like to reinforce the statutory directive that even permitted activities under the Volcker Rule must not pose a threat to the stability of the financial system and, specifically, the stability and integrity of the commodity markets and must not involve exposure to high-risk trading strategies.[8]

### 2. Enhancing Consumer Protection

The rule should also be exercised by the Commission and the Agencies as a means to help preserve and protect customer funds, especially in the wake of the MF Global crisis. Following the firm's collapse an estimated $1.6 billion in customer money had been unaccounted for. Thousands of brokerage clients, including several NEFI members, had their accounts frozen while regulators and court officials investigated the disappearance of funds. It is suspected that this customer money disappeared as a result of its alleged misuse in a complex scheme to channel it into unethical and risky investments through proprietary trading activities. Therefore the segregation, accounting and appropriate use of taxpayer-backed funds and insured client accounts, including commodity brokerage accounts, must be a major consideration as regulators finalize the Volcker Rule.[9] In response to Question 32 of the CFTC's request for comment, we oppose the blanket exemption for repurchase agreements or "repos," the trading practice alleged to have been used by MF Global to take a highly leveraged and risky financial positions in

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[7] *Comment Letter from the Americans for Financial Reform*, February 13, 2012

[8] As required under Section 13(d)(2) of the Bank Holding Company Act.

[9] The Securities Investor Protection Act of 1970 (codified at 15 U.S.C.78) excludes commodity brokerage accounts and so they do not enjoy the same protects as afforded securities brokerage accounts and other federally-ensured accounts and deposits. The CFTC must care to ensure that this does not exempt commodity brokerage accounts and related cash holdings from prohibitions on proprietary trading activities.

European sovereign debt.[10] MF Global used segregated customer funds when losses on that position caused a run by its lending counterparties. Therefore the loser, in the end, were its clients including as mentioned several of our members.

**3. Preventing Excessive Speculation**

As the Commission is well aware, PMAA, NEFI and their affiliate state associations and member companies continue to express serious concern about the financialization of the energy derivative markets and the role of excessive speculation. Extreme volatility and unwarranted price spikes for essential commodities including crude oil, gasoline, diesel fuel and home heating oil translates into considerable strain on both American businesses (due to an unjustifiable increase in hedging costs and input or wholesale costs) and, as a result, consumers. To-date, there have been more than 100 studies into the role of excessive speculation in the commodity markets, and as the body of evidence continues to grow, arguments in favor of federal action becomes that much more compelling.[11] Failure to address this ongoing crisis constitutes a major burden on commerce, restrains economic growth and jeopardizes the overall economic recovery. Implementation of a strong "Volcker Rule" is an essential part of the overall effort to address this crisis and should be considered as complimentary to other measures such as meaningful speculative position limits and margin requirements on financial traders.

As mentioned, in establishing the ban on proprietary trading, the Congress defined prohibited activities to include trading in commodity futures and forwards and derivatives thereof, including swaps and options. Congress enumerates such activities that "would result, directly or indirectly, in a material exposure by the banking entity to high-risk assets or high-risk trading strategies." PMAA and NEFI believe that all proprietary risk-taking in commodities should be included. We applaud the Commission for including in the definition of "covered financial positions" all positions (long, short, synthetic, and other positions) in derivatives and commodity futures and options, thereby ensuring that they are made subject to the rule's prohibitions on proprietary trading. Again, we also encourage that the definition be expanded to include spot commodities.

**4. Preventing Loopholes and Unwarranted Exemptions**

Like many other comments received from academic organizations, public interest groups, consumer advocates and *bona fide* hedging interests, we are concerned that ambiguities in the statute concerning exemptions from the prohibitions on proprietary trading could weaken Congressional intent, diminish consumer confidence and further destabilize the commodity markets. Many comments received from the financial community have encouraged broad definitions or expanded exemptions. We fear the intent is to include many risky commodity trading activities for the purpose of evading prohibitions on proprietary trading and preserve said commodity markets as a viable alternative should proprietary trading indeed be banned in other lucrative investments areas.

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[10] *77 Fed. Reg. 8348*

[11] A running list of all 100 studies, reports and analyses can be found at the New England Fuel Institute website at https://www.nefiactioncenter.com/PDF/evidence_on_impact_of_commodity_speculation.pdf

*i. High-Frequency Trading*

Concerning high-frequency trading, ("HFT") we agree with comments submitted to the Agencies by *Better Markets* that such trading practices not be considered for the purpose of defining the "market making" exemption.[12] That letter correctly identifies HFT as "a highly profitable source of proprietary trading" that has grown in popularity and that such practices "are not market makers and are not engaged in the permitted activity of market making." Further, the commission and other financial regulators in the United States and overseas have expressed concern about algorithmic trading in general and HFT in particular and the relative risks that such trading strategies pose to market stability and security. Therefore, in response to Question 50, high-frequency trading should most certainly be included in "covered financial positions."[13]

*ii. "Market-making"*

It is vital that the Commission and prudential regulators take great care in defining "market making" exemptions. Without thoughtful consideration in the application of the aforementioned statutory exemptions, regulators run the risk of inadequately safeguarding against a broader crisis should a systemically larger firm fail as the result of unethical, risky and misguided proprietary trading practices. We concur with the comments submitted by the *Americans for Financial Reform* and *Better Markets, Inc.* on the appropriate tailoring of the "market making" exemption and encourage strong consideration of their recommendations.

*iii. Hedging and Risk-mitigation*

The Commission correctly states that "hedging activities for which a banking entity has established a compensation incentive structure that rewards speculation in, and appreciation of, the market value of a covered financial position, rather than success in reducing risk, are inconsistent with permitted risk-mitigating hedging activities."[14] This is in keeping with the intent of its Congressional authors, who were concerned that banks might use commodity futures to circumvent prohibitions on proprietary trading:

> "…purchasing commodity futures to 'hedge' inflation risks that may generally impact the banking entity may be nothing more than proprietary trading under another name. Distinguishing between true hedges and covert proprietary trades may be one of the more challenging areas for regulators, and will require clear identification by financial firms of the specific assets and risks being hedged, research and analysis of market best practices, and reasonable regulatory judgment calls. Vigorous and robust regulatory oversight of this issue will be essential to the prevent 'hedging' from being used as a loophole in the ban on proprietary trading.[15]

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[12] See *Better Markets Comment Letter*, February 13, 2012, Page 12.

[13] Question 50 (*77 Fed. Reg. 8350)* more specifically asks whether or not the CFTC should "expand the scope of covered financial positions to include other transactions" such as "spot commodities" and spot commodities "traded on a high-frequency basis." NEFI and PMAA believe that they should and that all algorithmic-based trading should be broadly defined for the purposes of defining covered financial positions.

[14] *77 Fed.Reg. 8362,* Ref. §___.5(b)(2)(vi) of the proposed rule.

[15] Statement of Senators Merkley and Levin at 156 CR S5895 (Jul 15, 2010)

As opposed to legitimate hedging activities, which are intended to minimize risk, commodity speculation is a highly-leveraged, risk-permeated activity and therefore should not be conducted through the use of federally-insured deposits or taxpayer subsidies. Therefore, we applaud the Commission and the Agencies for their acknowledgement of the need for a *narrow* hedging exemption and urge its inclusion in the final rule.

*iv. Commodity Pools*

NEFI and PMAA applaud the Commission for including commodity pools in the definition of covered funds for the purposes of the prohibition on proprietary trading. We urge its inclusion in the final rule.

*v. Repurchasing Agreements*

As stated under the section on "Enhancing Consumer Protections" above, we oppose the exclusion of repurchasing agreements or "repos" from the prohibition on proprietary trading.

**5. Implementation**

It may be an understatement to say that the implementation of the Dodd-Frank Act is behind schedule. Still, we urge implementation of the "Volcker Rule" as quickly as possible. The CFTC has requested feedback should regulators opt for a "gradual, phased-in approach to implement the statute rather than having the implementing rules become effective at one time."[16] While we hope the Commission and the Agencies implement a final rule in its entirety and by the statutory deadline, we acknowledge this may be unrealistic given the delay of the overall Dodd-Frank implementation process. Should federal regulators indeed opt for a phased-in approach, it is vital that prohibitions on proprietary trading in the commodities markets and narrowly-tailored exemptions for *bona fide* hedging activities be given precedence.

**Conclusion**

Again, we commend the Commission and the Agencies for their hard work, and for considering the above comments and important recommendations as work to finalize this important rule. We would be happy to discuss the above comments in detail or answer any questions the Commissioners or their staff may have. Please feel free to contact PMAA Vice President Sherri Stone at (703) 351-8000 or NEFI Vice President for Government Affairs Jim Collura at (703) 945-1067. Thank you in advance for your consideration and for the opportunity to comment on the proposed rule.

Respectfully submitted,

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[16] *77 Fed.Reg. 8340,* Question 4.