June 29, 2012

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

Re: Aggregation, Position Limits for Futures and Swaps
(RIN 3038-AD82)

Dear Mr. Stawick:

Better Markets, Inc.[1] appreciates the opportunity to comment on the above-captioned proposed rules ("Proposed Rules") of the Commodity Futures Trading Commission ("CFTC"). The Proposed Rules clarify and amend the aggregation provisions of the rules related to position limits for swaps and futures ("Position Limits Rules"), in accordance with the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").

INTRODUCTION AND SUMMARY OF COMMENTS

The Position Limits Rules lie at the heart of Title VII. They are needed to ensure orderly and fair commodities markets that accurately reflect supply and demand fundamentals. The Dodd-Frank Act makes it quite clear that position limits are to be applied in the aggregate at the control entity level. Further, it removes any doubt that the CFTC has the authority and power to place limits on "any group or class of traders," thus enabling the CFTC to aggregate, for example, any and all positions held by subsidiaries of a given person or trader with that person or trader's own positions.

Congress thus gave the CFTC a **clear mandate** to set aggregate position limits. One consequence of that mandate is that some firms will have to adapt their previous business practices. This is a consequence of the law, and the CFTC has neither good reason nor authority to change the law. For instance, firms with "Chinese wall" provisions preventing one division from sharing information on its positions with another division may be forced to cease trading commodity derivatives in multiple divisions. Similarly, financial firms that own stakes in commercial firms may be forced to reorganize their operations. This is simply a consequence of the law, of policy decisions made by the Legislative and Executive Branches, and not a discretionary matter. Rather than weakening the existing rules to the point where they fail to adequately reflect Congress's mandate, the CFTC's task is to implement the law, even if that must take place over the objections of industry participants who view new laws as

[1] Better Markets, Inc. is a nonprofit organization that promotes the public interest in the capital and commodity markets, including in particular the rulemaking process associated with the Dodd-Frank Act.

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an imposition and threat to their lucrative business lines.

The CFTC found a working solution in its Position Limits Rules. Exemptions from the aggregation presumption were granted to Independent Account Controllers, and in cases where sharing information on positions between different internal divisions would cause a violation of Federal law. It is now being suggested that this clause, 151.7(i), be further weakened by waiving the need to provide an opinion of counsel, or by lowering the standard to "a reasonable risk" of violating Federal law. It is also proposed that the positions of commercial subsidiaries be taken out of the aggregation calculation, in order to preserve the status quo that existed prior to Dodd-Frank.

Further weakening of the aggregation provisions is not warranted. An opinion of counsel is a necessary requirement if the Position Limits Rules are to have teeth, and a minimum standard of a "very strong risk" of violating Federal law is appropriate. The statute is also quite clear that positions must "flow up" to the control entity level for position limits purposes, **regardless of whether or not a subsidiary is a commercial entity**. Thus, there can be no exemption for owned non-financial entities.

The objectives enumerated in the Dodd-Frank Act with respect to position limits do not include the maximum business convenience of financial speculators. Under the new regime, all accounts controlled by a given entity will be aggregated, and evasion of position limits will not be possible merely by creating artificial divisions within what is essentially one firm. The original Position Limits Rules captured this adequately, and **must not be weakened**.

Finally, it is important to note that position limits are not just designed to prevent excessive concentration; they are required to "diminish, eliminate or prevent" excessive speculation. As has been demonstrated by numerous academic studies and compelling data presented in previous letters to the CFTC,[2] the level of speculation in U.S. commodity markets today is currently excessive. The CFTC should therefore be looking to **strengthen** regulations on speculation, **not weaken** them.

DISCUSSION

In connection with the position limits set out in Section 737 of the Dodd-Frank Act, Congress included the following provision:

> "In determining whether any person has exceeded such limits, the positions held and trading done by any persons directly or indirectly

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[2] *See* Better Markets letter to CFTC dated March 28, 2011 ("Position Limits Comment Letter"), at pages 80-85, *available at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=34010&SearchText=better%20markets (incorporated herein as though fully set forth); *see also* Frenk, D. and Turbeville, W., "Commodity Index Traders and the Boom/Bust Cycle in Commodities Prices," *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1945570. For a list of further studies, *see* http://www2.weed-online.org/uploads/evidence_on_impact_of_commodity_speculation.pdf.

> controlled by such person shall be included with the positions held and trading done by such person."[3]

and:

> "[S]uch limits upon positions and trading shall apply to positions held by, and trading done by, two or more persons acting pursuant to an expressed or implied agreement or understanding, the same as if the positions were held by, or the trading were done by, a single person."[4]

Thus, it is clear that direct control of a trading account is not a condition of aggregation. Rather, "indirect control" is sufficient. Ownership is the paradigm example of indirect control. Thus, the statute dictates that trading accounts within an entity owned by another entity are to be aggregated with that parent company's positions.

An exception is where the parent company is legally and practically prevented from exerting even indirect control. Independent Account Controllers arguably fit this requirement. Chinese walls do not, except in the most unambiguous cases, precisely those cases in which an opinion of counsel to the effect that the sharing of information about positions between parent and subsidiary would pose a very strong risk of violating Federal law.

Therefore, the CFTC should not weaken the requirements set out in section 151.7(i) of the Position Limits Rule.

The Statute is Quite Clear that Positions Must "Flow Up" to the Control Entity Level for Position Limits Purposes, Regardless of Whether or Not a Subsidiary Is a Commercial Entity. Thus, There Can Be No Exemption for Owned Non-Financial Entities.

The language on direct or indirect control of positions is clear and unambiguous. It does not discriminate between commercial and non-commercial entities. Thus, the law unequivocally required the positions of owned non-financial entities to be aggregated with those of its parent company. It is just not appropriate to invoke the *bona fide* hedge exemption in attempting to justify an exemption for owned non-financial entities, since the *bona fide* hedging exemption applies only **after** aggregation, and only in cases where the control entity is itself "primarily engaged in commercial activities."

Nor do industry complaints that the law constitutes a "drastic departure from the status quo" hold any weight.[5] The status quo is precisely what the financial reform law was enacted to transform, restoring order to the de-regulated commodities markets. By including strong language on position limits, Congress expressed a clear opinion that financial speculators had damaged price discovery in commodities markets, and therefore undermined confidence and stability. The Commission has neither good reason nor authority to prioritize

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3 7 U.S.C. § 6a(a)(1).
4 *Id.*
5 Release at 31770.

the preferences of an industry working group over the clear language of the law as expressed by the Legislative and Executive Branches.

The Congressionally Mandated Purpose of Position Limits Prioritizes Market Integrity Over the Convenience of Financial Speculators.

Congress enumerated four objectives that the CFTC must seek to achieve as it sets position limits.[6] First and foremost on the list, and "to the maximum extent practicable," the agency must "diminish, eliminate, or prevent excessive speculation."[7] Other objectives include ensuring "sufficient market liquidity for *bona fide* hedgers," and ensuring that "the price discovery function of the underlying market is not disrupted."[8] These goals clearly place orderly market function, and the needs of commercial hedgers, at the forefront. Financial speculation is to be limited to serve these goals. At no point did Congress state that promoting and facilitating the profit-seeking activity of financial speculators should be an objective in and of itself.

Moreover, Congress explicitly clarified and strengthened the aggregation requirements previously contained in the Commodities Exchange Act by applying them to contracts in the same underlying commodity and to economically related contracts, across all venues. It further expanded the CFTC's powers to cover "any group or class of traders." The regime was clearly intended to be comprehensive and thorough. It was not intended to bestow upon the financial industry a right to speculate in commodities markets. If a firm's institutional structure prevents it from speculating on these markets, it is not the CFTC's job to bend the rules for that firm, compromising the clearly articulated objectives of Congress.

The Original Aggregation Provisions in the Position Limits Rules Were Adequate.

In the Position Limits Rules, the CFTC sought to implement the aggregation requirements of Section 737 of the Dodd-Frank Act in a balanced fashion. Exemptions from the aggregation presumption were granted to Independent Account Controllers, and in cases where sharing information on positions between different internal divisions would cause a violation of Federal law. In the latter case, an opinion of counsel would be required to support a claim that the sharing of information would cause a violation of Federal law. However, it is now being suggested that this clause, 151.7(i), be further weakened by waiving the need to provide an opinion of counsel, or by lowering the standard to "a reasonable risk" of violating Federal law.

Further Weakening of the Aggregation Provisions Is not Warranted.

An opinion of counsel is a necessary requirement if the Position Limits Rules are to have teeth, and a minimum standard of a "very strong risk" of violating Federal law is appropriate. The statute clearly lists "indirect control" as a criterion for aggregation. Therefore, in all but the most clear-cut cases of legal and practical information barriers, the presumption must be towards aggregating the positions of separate divisions or desks within

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6 7 U.S.C. § 6a(a)(3)(B).
7 *Id.*
8 *Id.*

a parent company.

At a Time When Data Shows that Speculation Is Excessive, the CFTC Should Be Looking to Strengthen Its Regulations on Speculation, Not Weaken Them.

Finally, it is essential to note that position limits are not just designed to prevent excessive concentration; they are required to "diminish, eliminate or prevent" excessive speculation. The CFTC has been presented with numerous academic studies and compelling data which demonstrate that the level of speculation in U.S. commodity markets today is currently excessive.[9] The CFTC should therefore be looking to strengthen regulations on speculation, not weaken them. Indeed, given the Congressional mandate to "eliminate, diminish or prevent excessive speculation," the CFTC is required to hold a strong line on aggregation.

CONCLUSION

There is no reason for the Commission to weaken its original aggregation provisions for position limits. The integrity of the markets and the fortunes of America's end-users depend on the Commission maintaining a strong line.

Sincerely,

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[9] *See* Better Markets Position Limits Comment Letter at pages 80-85.