The Real Estate Roundtable

CENTER FOR CAPITAL MARKETS
COMPETITIVENESS

June 29, 2012

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

Re: RIN number 3038–AD82 – CFTC Request for Comment Regarding Notice of Proposed Rulemaking on Aggregation, Position Limits for Futures and Swaps

Dear Mr. Stawick:

The U.S. Chamber of Commerce is the world's largest business federation representing over three million companies of every size, region and industry sector, including, among others, technology, agriculture, real estate, manufacturing, and energy. The Real Estate Roundtable represents the principal owners, investors and managers of the U.S. income-producing commercial and multifamily real estate sector. We appreciate the opportunity to provide input to the Commodity Futures Trading Commission (the "CFTC") regarding the above referenced notice of proposed rulemaking which, if adopted, would modify the CFTC's policy for aggregation under the position limits regime in the CFTC regulations.

Background

In 2011, the CFTC adopted final rules (the "Position Limits Rules") that establish new "position limits" on derivatives positions across the listed futures, options and swaps markets in order to prevent "excessive speculation and market manipulation."[1] Notably, the Position Limits Rules also establish account aggregation standards, which will require the aggregation of derivatives positions based on certain levels of ownership, with no regard to whether the owner exercises control over the trading activities of the investee entity.

[1] *Position Limits for Futures and Swaps*, 76 Fed. Reg. 71626 (Nov. 18, 2011), p. 71627.

Following petitions from certain commercial firms, the CFTC recently proposed amendments to the Position Limits Rules—ostensibly to provide some relief from the burdens of aggregation. The proposed relief would exempt investments between 10 and 50 percent from automatic aggregation based on the satisfaction of certain additional criteria.[2] For investments greater than 50 percent, the aggregation requirements would automatically apply even if an investor has no control over or involvement in the day-to-day trading or hedging activities of investee companies.

As discussed below, we have significant concerns that these broad aggregation requirements will impose substantial costs and burdens on commercial enterprises and their investors without creating significant benefits for the markets. Furthermore, we believe that the CFTC's proposed aggregation relief is insufficient and will be of little practical utility to a large number of commercial firms and investors.

Discussion

In the first instance, the Position Limits Rules apply to 28 physical commodity futures contracts, as well as futures and swaps that are economically equivalent to those contracts. However, the aggregation requirements established in Section 151.7 of the Commission's Regulations will also apply to contracts traded on designated contract markets (DCMs) and swap execution facilities (SEFs), such as interest rate and foreign exchange products. Specifically, under Section 151.11(e) of the CFTC's Regulations, the aggregation requirements will apply to *all* position limit and position accountability levels imposed by DCMs and SEFs. Consequently, a commercial firm or investor exceeding a specified ownership threshold in a company could be attributed the derivatives activity of such owned company—whether such activity relates to physical commodities futures identified in Section 151.2 of the CFTC's Regulations (such as energy or metal) or other types of derivative instruments (such as interest rate or currency swaps).

As a practical matter, the consequences of this broad application of the aggregation requirements are two-fold. Of course, the aggregation requirements directly impact commercial firms (and investors in such firms) that actively trade in the referenced physical commodities described in Section 151.2 of the CFTC's

[2] *Aggregation, Position Limits for Futures and Swaps*, 77 Fed. Reg. 31767 (May 30, 2012).

regulations. However, there also is an important impact for commercial firms and investors that do not actively trade in such commodities but utilize other non-physical derivatives, including for non-speculative purposes.

In particular, many commercial firms throughout the world—including many of our members—use derivative instruments primarily for hedging purposes—i.e., to mitigate and manage the commercial risks attendant to their commercial activities. For example, a U.S. manufacturing company may have outstanding liabilities denominated in a foreign currency. In order to hedge against risks in connection with fluctuations in the exchange rate, the company may enter into a currency swap. Similarly, in connection with a building loan, a commercial real estate company may enter into an interest rate swap agreement with its lender in order to protect itself against material rises in future interest rates. Commercial companies also regularly manage their exposure to price fluctuations using contracts on agricultural, metal and energy contracts. In each of these examples, the company's use of a swap is not made in connection with some larger trading or speculative investment strategy. Rather, the company is simply attempting to mitigate future risks that could adversely impact its commercial operations or the company's cash flow.

The Position Limits Rules' aggregation requirements threaten to markedly and impractically impair many commercial firms' (including real estate companies') ability to engage in these legitimate risk management activities. Many of our members are under common ownership with, or themselves invest in, otherwise unrelated and independent commercial businesses. In these circumstances, the applicable investors typically invest in the commercial businesses as a going concern and do not exercise control over the day-to-day derivatives trading or hedging activities of the owned entity. However, notwithstanding this lack of control over day-to-day trading decisions, under the Position Limits Rules, the investor must aggregate the derivative positions of each of these unrelated investee businesses for any of the referenced contracts. Further, to the extent that the investor trades on a SEF or DCM, the investor would be required apply the same aggregation rules to the derivatives positions of unrelated investee business in order to comply with SEF and DCM position limits and accountability standards for all contracts, including those referencing excluded commodities. With respect to these commercial entities that engage in independent and uncoordinated operations, aggregation is neither justified nor, on the terms proposed by the CFTC, practical to comply with. Among other

effects, the aggregation requirements will likely have immediate and long-term adverse consequences for commercial firms and their investors, including:

- Requiring commercial firms to restrict their risk management activities simply because they are under common ownership with other unrelated businesses;

- Requiring investors to more fully insert themselves into the operational activities of investee commercial firms in order to ensure compliance—creating the potential for increased market power not currently in effect;

- Requiring investors to establish coordinated derivatives trading across unrelated investee commercial entities, which, similar to the above bullet point, is contrary to the objectives of the Position Limits Rules; and

- Requiring development and implementation of costly monitoring systems to ensure real-time compliance with applicable intra-day position limits.

- Implementing a compliance program sufficient to prevent violations of position limits across investees may require commercial entities to share confidential hedging and transaction information.

More broadly, the aggregation requirements may put some commercial businesses that are under common ownership with other unrelated commercial businesses at a competitive disadvantage. In particular, such companies may not be permitted to access the full range of risk management tools available to their non-owned competitors. Further, aggregation may act as a disincentive to capital investment in commercial businesses as investors weigh the costly and time-consuming compliance burdens associated with monitoring derivatives exposure of operating company investments. As such, the aggregation requirements may have the effect of eliminating a vital source of capital necessary to sustain and expand commercial businesses in the economy. Furthermore, the purpose of the Position Limits Rules is not served by requiring an investor who does not control the trading of the commercial businesses in which it is invested to aggregate derivative positions. Indeed, it is not clear that ownership-based aggregation rules will reduce "excessive

speculation and market manipulation," particularly by sweeping in companies' most basic hedging activities.

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The aggregation relief proposed by the CFTC is insufficient to address the above concerns. It does not appear that the CFTC realistically assessed the substantial costs, burdens and impact of such aggregation requirements in adopting the Position Limits Rules. Furthermore, the proposed 50 percent ownership test fails to comport with or appreciate practical commercial realities. Instead, such threshold attempts to set a bright-line that sacrifices usefulness in the name of certainty. We appreciate that aggregation standards based on control of trading may be appropriate. However, it is unnecessary to extend these standards to a wide swath of market participants based on an arbitrary ownership threshold. Accordingly, we respectfully request that the CFTC revise the proposal to develop a practicable solution to the aggregation concerns voiced above.

Sincerely,

The Real Estate Roundtable
U.S. Chamber of Commerce