Deutsche Bank

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Via Federal eRulemaking Portal

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

Re: Position Limits for Derivatives (RIN 3038-AD99) (78 Fed. Reg. 75680) (December 12, 2013) (the "Position Limits Proposal") and Aggregation of Positions (RIN 3038-AD82) (78 Fed. Reg. 68946) (November 15, 2013) (the "Aggregation Proposal" and collectively, the "Proposals")

Dear Mr. Stawick:

DB Commodity Services LLC ("***DBCS***"), a Delaware limited liability company that is a registered commodity pool operator ("***CPO***") and commodity trading advisor ("***CTA***"), welcomes the opportunity to submit this letter in response to the Commodity Futures Trading Commission's ("***Commission***" or "***CFTC***") request for comments in respect of the Proposals. DBCS has been registered with the Commission and has been a member of the National Futures Association since 2005. Its principal place of business is 60 Wall Street, New York, New York 10005, telephone number (212) 250-5883. DBCS is a wholly-owned subsidiary of DB U.S. Financial Markets Holding Corporation, which is a wholly-owned, indirect subsidiary of Deutsche Bank AG. DBCS currently operates 11 commodity pools traded on NYSE Arca, a national securities exchange, in 2013 having in the aggregate approximately 1.2 million public investors and approximately $9 billion in investor assets.

In our comments, Section I offers general remarks, and Section II responds to certain questions posed by the Proposals.

I. General Comments.

Derivatives markets serve a vital role in the health of our economic system: they provide a critical price discovery mechanism, enable hedgers to offset risks, allow speculators to express

their views on price movements across various assets (whether up or down) and, via passive index funds, permit investors to hedge against inflation and diversify their investment portfolios. DBCS supports the Commission's efforts to maintain fair and orderly markets. However, DBCS believes that the Proposals do not take into account that passive index funds do not pose the concerns that motivate the proposed position limit rules. As such, certain components of the Proposals threaten to undermine the functions of derivatives markets listed above, and would unnecessarily impede the activities of passive index funds.

As discussed in more detail in Section I(1) below, we respectfully urge the Commission to recognize that the application of position limits to passive index funds is unnecessary. Passive index funds help bring about the stability that the Commission seeks to accomplish through regulation, and provide significant liquidity to the markets without raising the concerns of corners, squeezes or other manipulative activity through accumulation of large physically-settled positions in a commodity. Moreover, compliance with the proposed method of account aggregation would be, at best, terrifically costly, and, at worst, impossible for a large financial holding company and its affiliates to administer.

In addition to addressing how the Proposals should be revised to recognize the distinct role of passive index funds, this letter provides comments on: (a) the calculation of initial non-spot month position limits (Section I(2)), (b) the anti-circumvention provision applicable to commodity index contracts (Section I(3)), (c) the independent account controller exemption (Section I(4)) and (d) certain questions raised in the Aggregation Proposal (Section II).

1. The Proposals Should Recognize that Passive Index Funds Do Not Raise the Concerns Motivating Position Limits.

A. Passive Index-Tracking Funds Should be Exempt From Any Proposed and Existing Position Limits

Passive, unleveraged long-only index-tracking trading strategies used by many publicly-traded commodity pools, as well as by index tracking pools that are leveraged and/or also take short positions (each a "***Passive Pool***"), can be distinguished from actively managed commodity pools. A Passive Pool is not a "speculator" within the intent of Commission Regulation 1.3(z) (or its successor). A Passive Pool's investment objective is simply to track an index over time, regardless of whether the index is rising, falling or flat. To that end, a Passive Pool acquires long futures positions in the commodities making up the underlying index. A Passive Pool does not utilize a discretionary trading program but simply seeks to track the underlying index with minimal tracking error.

Dodd-Frank requires the Commission to impose position limits "as appropriate" in order to prevent excessive speculation and market manipulation. Passive Pools do not have the capability to manipulate physical commodity prices which is one of the ills the position limits regime is intended to prevent. It is a fundamental principle of the futures market that prices are set in the cash market by supply and demand for the actual physical commodities. However, Passive Pools do not provide the market with either supply or demand as the funds do not own, store, buy, sell or consume any commodities. Passive Pools do not concentrate their positions in any one futures contract or swap so that their investment decision could affect the price in the

underlying physical commodity. In addition, Passive Pools, in their primary role as an aggregator, change the size of their positions only as a result of individual investors investing or divesting in the pool and not as a result of a pool-wide investment strategy.

Further, Passive Pools apply *zero* net buying pressure across the commodity term structure. As Passive Pools cannot and do not hold positions into the delivery month, the primary market activity in which these unique market participants engage is the simple "rolling" of futures as they approach the spot month. This "rolling" occurs by selling nearby contracts and simultaneously buying an equal dollar amount of a more deferred contract. At the point of convergence of the cash and the futures markets (at the near end of the futures curve), Passive Pools are heavy net sellers as they sell their nearby current futures holdings in order to roll into more distant futures positions. Thus as futures contracts become deliverable to and converge with the physical market, index funds are no longer involved in those contracts and have no effect on the physical price determination process.

Dodd-Frank also requires that the position limits regime ensure sufficient market liquidity for bona fide hedgers. Passive Pools create a more liquid and efficient futures market for hedgers and speculators alike. Passive Pools own futures contracts for the purpose of providing their underlying investors with portfolio diversification and inflation hedging. They do not take positions, short or long, in anticipation of future price movements. Often, Passive Pools participate in illiquid contracts, thereby bringing liquidity where none existed.

The function of investors such as Passive Pools as liquidity providers was recognized by Congress during the Dodd-Frank legislative process. Senator Blanche L. Lincoln (D-AR)[1] clearly articulated that the Dodd-Frank position limits regime is not intended to restrain or substantially reduce the participation of such investors in the commodities markets. As Sen. Lincoln said, in setting position limits, the Commission

> must balance the needs of market participants, while at the same time ensuring that our markets remain liquid so as to afford end-users and producers of commodities the ability to hedge their commercial risk. Along these lines I do believe that there is a legitimate role to be played by market participants that are willing to enter into futures positions opposite a commercial end-user or producer. Through this process the markets gain additional liquidity and accurate price discovery can be found for end-users and producers of commodities.

Sen. Lincoln further expanded on the liquidity-providing role of investors like Passive Pools in her comment letter to Chairman Gensler dated Dec. 16, 2010, where she noted that such investors provide an important source of liquidity to commercial hedgers, serve a price discovery function and provide an important inflation hedge to retail investors. Sen. Lincoln stressed that imposing unnecessary position limits on such investors

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[1] July 15, 2010 Senate Floor speech, during the consideration of the Dodd-Frank Conference Report, Congressional Record-Senate, pages S5919-20, CREC-20 1O-07-15-ptl-PqS5902.pdf (pages S5919-20).

could limit their investment options, potentially substantially reduce market liquidity, and impede price discovery. Such limits might also have the unintended consequence of forcing investors to rely on higher-cost managers with little experience, insufficient compliance and trade flow infrastructure, and limited risk management capabilities associated with effectively managing commodity index risk.

In summary, Passive Pools accomplish the same ends at which the Proposal aims. The Commission seeks to balance and calm the markets, but the markets are already more balanced and calmer because of the activities of Passive Pools. Passive Pools cannot manipulate the market nor do they engage in speculation. On the contrary, they provide an important source of liquidity to bona fide hedgers and other market participants. They permit the small investor, as well as large investors such as pension funds and endowments, to gain access to and profit from the markets without incurring potentially large risks. Without such access, these investors may find it necessary to open individual futures trading accounts, thereby increasing the risk and volatility with respect to their invested funds. Passive Pools are highly regulated, highly transparent, and unleveraged Passive Pools are conservative in approach: they seek incremental growth and minimal loss through passive investing. In this fashion, the introduction of the small investor via Passive Pools increases the market's capacity for risk-sharing.

Section 4a(a)(7) of the Commodity Exchange Act ("***CEA***") authorizes the Commission to exempt from position limits "any person or class of persons". The Commission should rely on this authority to exempt Passive Pools from the position limits regime.

Additionally, rather than imposing strict limits, the Commission should consider adopting "position accountability" standards similar to those currently administered by futures exchanges. Position accountability, rather than position limits, would permit the Commission to require traders who own or control positions in excess of certain thresholds to provide the Commission, upon request, with information regarding the nature of the positions, hedging needs, and the trading strategy to enable the Commission to determine at that time the appropriate course of action, rather than arbitrarily imposing limits on all traders.

Finally, if the Commission does adopt speculative position limits, the different exchanges should either withdraw their position accountability and position limits regimes in deference to any new Federal requirements, or conform them accordingly, so that a single regime will apply across exchanges.

B. <u>In Adopting an Exemption for Passive Pools, the Commission Should Rely on Past Precedent</u>.

The Commission staff granted, but then three years later rescinded, no-action relief to two passive long index-based funds from speculative position limits on certain agricultural commodities. *See* CFTC Letter 06-09 (April 19, 2006); CFTC Letter 06-19 (September 6, 2006). The no-action letters provide guidance in establishing an exemption for Passive Pools. In 2009, the Commission staff affirmatively determined that these funds "represented a legitimate and potentially useful investment strategy." 74 Fed. Reg. 12282 (CFTC, March 24, 2009), at footnote 15.

As stated in the no-action letters, Passive Pools include the following attributes: (i) passive tracking of a benchmark; (ii) excess positions not affecting the spot month futures contract; (iii) high level of transparency; (iv) extensive federal and self-regulatory oversight; and (v) lack of price exposure to the fund. *See* CFTC Letter 06-09 at 4; CFTC Letter 06-19 at 5-6.

These unique features of Passive Pools allow them to actively participate in the commodity futures market while still providing substantial protections and full disclosure to market participants and the investing public. Their activities do not cause the concerns that the Proposal is intended to address. Additionally, limiting the ability of Passive Pools to trade in the futures markets will: (i) expose retail passive investor customers to bilateral credit risks; (ii) increase price volatility and reduce liquidity; and (iii) force more retail customers to access the futures markets directly. We believe that the Commission should codify rules exempting Passive Pools from speculative position limits or adopt a separate position limits exemption for Passive Pools.

Most Passive Pools are passive long traders, as is evident from a review of their disclosure documents. The Commission could consider having such pools file a certificate with the Commission confirming their status as an "Index-tracking Exchange-traded Pool" and, to the extent any speculative position limits are imposed, aggregation rules and exemptions applicable to these uniquely transparent and highly regulated collective investment vehicles should be adopted.

C. Positions of Passive Pool Should Not Be Attributed to the CPO Based on Control.

Under proposed rule 150.4(a), positions of Passive Pools would be attributed to the CPO because the CPO would likely be regarded as having "control" over those positions.

We disagree with that application of the proposed rule. Passive Pools do not trade based on a discretionary trading strategy. Instead, they assume positions solely to track a predefined index. DBCS's role as a CPO with respect to its funds consists of (i) selecting parties that are necessary to administer the pool's activities such as the trustee, the commodity broker, administrator, custodian, transfer agent, distributor, marketing agent and auditor; (ii) negotiating various agreements and fees; and (iii) monitoring the performance results of the pool's portfolio and reallocating assets within the portfolio with a view to causing the performance of the pool's portfolio to track that of the relevant index.

The CPO does not have the discretion to react to market movements so, for example, even if the index were to generate negative returns for extended periods of time, the CPO would not have the power to reshuffle the portfolio and would have to keep making investments solely to track the negative-performing index. Thus, the CPOs role does not involve "control" in the usual meaning of that word as the ability to influence the trading decisions of an entity. Because the CPO is not capable of making decisions that are speculative in nature or express a market view, it is unable to cause the harm that the position limits regime is intended to prevent and the positions of the commodity pools should not be attributed to the CPO.

The Commission's aggregation regime must prudently apply the limits to passive index-tracking CPOs who use the futures markets for legitimate risk management purposes, in a manner that does not penalize those CPOs who operate multiple commodity pools, each a separate legal entity, each having its own public investor beneficial owners, each tracking a different index and over which the CPO does not exercise "control". Imposing speculative position limits without also adopting a realistic aggregation policy that permits responsible traders, such as a regulated CPO, to trade in these markets without the positions in one of its pools being aggregated with those of its other pools, will decrease liquidity and impair price discovery, causing pools to move their trading to foreign markets.

The Commission should not attribute the positions of passive index-tracking commodity pools to the CPO in situations where, as described above with respect to DBCS, there exists no "control". The Commission should adopt an aggregation rule that disaggregates the positions of highly regulated passive index-tracking commodity pools from other pools that either (a) are operated by the same CPO or (b) track the same index, where there is either no common control or no common ownership among the investors that own 10% or more of the pools.

2. Initial Single Month and All Month Position Limits Should be Increased to Reflect Open Interest in Swap Markets.

For setting non-spot month limits (*i.e.*, the single month, and all months combined limits), the position limit rules should use a formula based on combined open interest from futures, options and *all* swaps that are Referenced Contracts with respect to the relevant Core Referenced Futures Contract. Instead, the proposal would calculate open interest based on futures, options and only those swaps that were significant price discovery contracts (SPDCs) traded on exempt commercial markets (ECMs). Some swaps that will qualify as Referenced Contracts and thus be subject to position limits may not have had to be traded as SPDCs on ECMs. Accordingly, using open interest in SPDCs traded on ECMs is likely to underestimate actual open interest in swaps that would be subject to the proposed position limits regime. We respectfully request that the Commission multiply open interest observed in SPDCs traded on ECMs by a factor that corrects for any under-estimate.

3. Using Swaps Settled on Commodity Indexes Should Not be Viewed as Circumvention

The definition of "Referenced Contract" under proposed rule 150.1 generally excludes commodity index contracts. Under proposed rule 150.2(h), however, a commodity index contract used to circumvent speculative position limits is considered a Referenced Contract. We respectfully request that the Commission provide additional guidance as to when a commodity index contract will be viewed as being used to circumvent speculative position limits. A number of factors unrelated to circumvention exist for using commodity index contracts in lieu of futures, options or those swaps that do not qualify as Referenced Contracts (such as single product swaps). These factors include, among others: (a) the costs of entering and maintaining the relevant position via a commodity index contract as opposed to the substitute Referenced Contracts, (b) the operational capacities supporting trading in the alternate contracts, including relationships with market intermediaries, and (c) the potential for trading through certain instruments (particularly in large volumes) to detrimentally disclose strategies and positions. In providing guidance as to circumstances in which a commodity index contract may be treated as a

Referenced Contract under proposed rule 150.2(h), we respectfully urge the Commission to recognize the existence of legitimate factors (such as those listed above) for using a commodity index contract instead of one or more Referenced Contracts that may in part or in whole be used to reproduce the performance of the relevant commodity index contract. In addition, we respectfully request confirmation that a commodity index contract will *not* be viewed as being used for purposes of circumvention (and thus will *not* be treated as a Referenced Contract) solely because it settles on the basis of an index that could have been partly or fully reproduced through a position in futures, options or swaps that qualify as Referenced Contracts.

4. Support for Preservation of the Independent Account Controller Exemption

We strongly support the preservation of independent account controller exemption under the Aggregation Proposal. We agree with the Commission that retaining the IAC exemption for independently managed client accounts is in accord with the purposes of the aggregation policy.[2] The 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. Such concern is mitigated in circumstances involving accounts managed under the discretion and control of an independent trader and subject to effective information barriers. A wide variety of commodity trading programs has developed to meet the demands of market participants. To the extent that accounts participating in these programs trade independently, the trading enhances market liquidity for bona fide hedgers and promotes efficient price discovery without posing the risk of coordinated trading that may result in market manipulation or disruption. The IAC exemption appropriately balances these benefits of independently conducted trading programs with the protection of commodity markets through conditioning availability of the IAC exemption on limitations on sharing of information and control over trading decisions.

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II. Responses to Commission's Questions regarding Aggregation Proposal.

We have provided general comments related to both Proposals above. Our responses to certain of the specific questions posed by the Aggregation Proposal follow:

Question 1(Exemption from Aggregation for Legal Restrictions on Information Sharing): With respect to Rule 150.4(b)(8), the Proposal solicits comment as to (a) the appropriateness of requiring that a person provide a written memorandum of law, rather than an opinion of counsel, regarding the reasonable risk of a violation of law?

We support the proposal to permit a written memorandum of law in lieu of an opinion of counsel. We believe that this revision appropriately reflects that many market participants have sophisticated in house legal departments as well as the potential use of trade organizations to address questions shared across an industry. In many cases, the factual background and legal analysis relevant to informing the Commission as to legal restrictions on information sharing

[2] Position Limits for Futures and Swaps, 76 Fed. Reg. 71626, 71652 (Nov. 18, 2011).

may be developed as well (if not better) in a memorandum produced "in-house" or by a trade organization as by an opinion of outside counsel. Furthermore, permitting this alternative may reduce the costs of satisfying the conditions to this exemption.

Question 2 (Additional Exceptions to Aggregation on Account of Ownership): The Proposal notes that instances have come to the Commission's attention where beneficial ownership in otherwise unrelated accounts may be greater than ten percent, but the circumstances surrounding the financial interest clearly exclude the owner from control over the positions. The Proposal requests comment on whether further revisions to the current Commission rules and policies regarding ownership are advisable in light of the exemption being proposed and, if such financial interests raise issues not addressed by the proposed exemption for independent account controllers, what approach best resolves those issues while maintaining a bright-line aggregation test?

In Section I(1), we discuss reasons why the activities of Passive Pools do not raise the concerns that the position limits regime is intended to address. Section I(1)(C) specifically addresses aggregation that may be imposed on CPOs of Passive Pools on account of control. We respectfully request that, for where the general limitations on aggregation of passive interests in commodity pools (proposed to be retained substantively but clarified and reorganized under 150.4(b) by the Aggregation Proposal) are insufficient to exempt a person with a ten percent or greater interest in a Passive Pool from requirements to aggregate with that pool, a separate exemption from aggregation on account of ownership be introduced for Passive Pools.[3]

Question 3 (Pro-Rata Aggregation): The Proposal solicits comments as to whether the Commission should adopt an approach that would require aggregation of only a pro-rata allocation of owned-entity positions to equity owners based on the percentage of ownership interest?

We support the pro-rata aggregation of an owned-entity's positions with the positions of its owners. Absent pro-rata aggregation, the same positions may be attributed to two or more investing entities leading to double counting. Pro-rata aggregation would also more properly reflect the incentives to engage in manipulative conduct that the position limits rule is intended to prevent. To illustrate, consider the following example:

> There are two parent entities, Owner A and Owner B, that have interests in two subsidiaries, Subsidiary A and Subsidiary B. Owner A holds all of the equity of Subsidiary A, whereas Owner B holds only ten percent of the equity in Subsidiary B. Each of the Subsidiaries has the same positions in Referenced Contracts.

Absent pro-rata aggregation, Owner A and Owner B would be attributed the same positions (as we have assumed that Subsidiary A and Subsidiary B have the same positions in Referenced Contracts). However, Owner B's financial incentives to manipulate markets to profit through Subsidiary B's positions are clearly significantly lower than the financial incentives of Owner A; this is because Owner B would only internalize ten percent of any gains through such

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[3] In particular, the requested exemption would be relevant under proposed rule 150.4(b)(1)(iii) with respect to an investor holding a 25 percent or greater ownership or equity interest in a Passive Pool the operator of which was exempt from registration under Commission rule 4.13.

manipulation, whereas Owner A would internalize one hundred percent of the gains. Treating all owners that meet the ten percent threshold and do not qualify for an exemption from aggregation the same as an owner with a hundred percent interest is an unduly harsh result. We believe that the pro-rata approach proposed by the Commission appropriately mitigates this harsh result, reflecting the economic reality that the interests of a partial owner are only partially aligned with the investee.

To address administrative burdens application of a pro-rata regime may raise for investors and the Commission, we recommend permitting entities to opt into pro-rata aggregation and in so doing commit to informing the Commission promptly upon a change in their ownership or equity interest.

Question 4 (Consequences of Textual Clarifications): The Proposal would implement a set of clarifying revisions to the structure and language of CFTC Rule 150.4. The Proposal invites commenters to address whether the revised text of rule is easy to understand and apply?

We support the clarifications proposed to be made to the structure of rule 150.4, and particularly the reorganization of exemptions from aggregation into a single sub-section (i.e., 150.4(b)). We believe that the revisions will make the rule more accessible, lowering the costs of compliance.

Question 5 (Exemption for Normal Broker-Dealer Activity): The Proposal solicits comment as to the appropriateness of the proposed treatment of ownership interests acquired in the normal course of the broker-dealer's activity.

We support the proposed exemption from aggregation that would be applicable to ownership interests acquired in the normal course of dealer activities (such as the normal course of a dealer's market making activity) under proposed rule 150.4(b)(7).

Question 6 (IAC Exemption Modifications): The Proposal solicits comment as to the appropriateness of treating limited liability companies (LLCs) that are commodity pools in the same way as limited liability partnerships (LLPs) that are commodity pools? Commenters are invited to provide information regarding the considerations that determine whether commodity pools are, in practice, structured as LLCs or LLPs and whether there are any relevant differences in the two types of entities.

We support the proposed inclusion of limited liability companies as properly reflecting the development of the pooled investment vehicle industry, which now uses a variety of organizational forms. We believe it is appropriate to treat commodity pools organized as limited liability companies no differently than commodity pools organized as limited liability partnerships because the form of organization has no relation to how a commodity pool's positions may affect commodity markets.

III. Conclusion

DBCS appreciates the opportunity to comment on the Proposal and respectfully submits these comments for the Commission's consideration. Please contact our outside counsel,

Michael Sackheim of Sidley Austin LLP at (212) 839-5503 or Frank Gecsedi of DBCS at (212) 250-4713 with any questions regarding this letter.

Respectfully submitted,

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DB Commodity Services LLC

cc: Michael S. Sackheim
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