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February 10, 2014

Ms. Melissa Jurgens
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: Aggregation of Positions Notice of Proposed Rulemaking

Dear Ms. Jurgens:

CME Group[1] respectfully submits these comments on the Notice of Proposed Rulemaking entitled "Aggregation of Positions," which proposes new standards for, and exemptions from, the requirement to aggregate and attribute positions in separate accounts to a single trader ("2013 Aggregation Proposal"). Meaningful aggregation and attribution are crucial to administering position accountability levels and position limits and to detecting unacceptable concentrations of market power.

CME Group shares the Commodity Futures Trading Commission's ("CFTC" or "Commission") mission to combat price manipulation and other disruptions to the integrity of commodity prices. The Commission's existing aggregation rules are effective in serving this mission. The Commission has not identified any deficiencies in its existing system that would justify the costly and unnecessary changes proposed. For the reasons discussed below, CME Group respectfully recommends that the Commission refrain from adopting the 2013 Aggregation Proposal in any final rulemaking.

Executive Summary

CME Group has a strong interest in the CFTC's aggregation standards and exemptions not only because market participants will have to comply with any aggregation rules that are adopted, but also because our designated contract markets ("DCMs") would be responsible for enforcing those aggregation rules under an accompanying release.[2] As proposed, the Commission's aggregation rules are simply indefensible and onerous. The 2013 Aggregation Proposal consistently and erroneously invokes "longstanding" Commission precedent to support its inflexible and non-discretionary corporate

[1] CME Group is the holding company for four separate Exchanges, including the Chicago Mercantile Exchange Inc. ("CME"), the Board of Trade of the City of Chicago, Inc. ("CBOT"), the New York Mercantile Exchange, Inc. ("NYMEX"), and the Commodity Exchange, Inc. ("COMEX") (collectively, the "CME Group Exchanges" or "Exchanges"). CME Clearing is one of the largest central counterparty clearing services in the world; it provides clearing and settlement services for exchange-traded contracts and over-the-counter ("OTC") derivatives contracts through CME ClearPort®. The CME ClearPort® service mitigates counterparty credit risks, provides transparency to OTC transactions, and brings to bear the Exchanges' market surveillance monitoring tools.

[2] *See* Position Limits for Derivatives, 78 Fed. Reg. 75,680, 75,756-57 (Dec. 12, 2013); proposed rule 150.5(a)(5).

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ownership standard even when the Commission has stated in a prior rulemaking that "its own experience...suggests that the application of any standards concerning position aggregation for speculative limit purposes requires judgment in particular circumstances."[3] Thus, contrary to the Commission's claims in the 2013 Aggregation Proposal,[4] the proposed aggregation rules represent an unexplained departure from the Commission's administrative precedent and are not "more permissive" than the CFTC's existing aggregation requirements. In certain instances—particularly with the proposed "substantially identical trading strategies" aggregation requirement—the rules do not even provide sufficient guidance for market participants to be able to comply with them and for DCMs to enforce them. If the proposed aggregation regime is adopted, it will encourage market participants to shift their trading from U.S. commodity derivatives markets to markets abroad. Notably, in contrast to DCMs, registered foreign boards of trade ("FBOTs") would not be required to implement the Commission's costly and unjustified aggregation rules.

CME Group focuses its comments on two major problems with the 2013 Aggregation Proposal that bear on its legality and administrability: (1) the 2013 Aggregation Proposal has failed to identify inadequacies with the existing aggregation regime, thereby precluding a meaningful opportunity to comment on the proposed dramatic changes to that regime; and (2) the features of the CFTC's proposed aggregation regime under the 2013 Aggregation Proposal—namely, the owned entity aggregation rules, the independent account controller ("IAC") exemption, and the "substantially identical trading strategies" rule—are not in accordance with law and are arbitrary and capricious in violation of the Administrative Procedure Act ("APA").

I. The Commission has failed to identify any problems with its existing aggregation regime

Courts have long recognized that an agency must follow its own precedent or provide a reasoned explanation for departing from that precedent.[5] The 2013 Aggregation Proposal provides no evidence of abuse of the existing aggregation rules, nor any other record basis, for the Commission to radically depart from those aggregation rules. The Commission's proposed departure from the existing aggregation regime, moreover, was not required by the Commodity Exchange Act ("CEA" or the "Act"), as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), because the relevant aggregation provisions in the Act were left unchanged by Dodd-Frank. To the extent the CFTC has obliquely suggested that the existing aggregation regime is too restrictive and that the proposed regime would be "more permissive" by expanding the circumstances in which disaggregation would be allowed—that claim is demonstrably false.[6] The proposed aggregation regime unjustifiably expands the circumstances in which aggregation is required compared to the status quo.

The CFTC's failure to identify any problems with the status quo precludes a meaningful opportunity to comment on the proposed dramatic changes to the status quo. In other words, market participants

[3] *See* Establishment of Speculative Position Limits, 46 Fed. Reg. 50,938 (Oct. 16, 1981).

[4] Aggregation of Positions, 78 Fed. Reg. 68,946, 68,968 (Nov. 15, 2013).

[5] *See*, *e.g.*, *BB&L Inc. v. NLRB*, 52 F.3d 366, 369 (D.C. Cir. 1995) (per curiam) (regarding the agency's ignoring of its own relevant precedent); *Greater Boston Television Corp. v. FCC*, 444 F.2d 841, 852 (D.C. Cir. 1970) ("[A]n agency changing its course must supply a reasoned analysis indicating that prior policies and standards are being deliberately changed, not casually ignored.").

[6] *See* 78 Fed. Reg. at 68,968.

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cannot meaningfully participate in the Commission's rulemaking process because they are unaware of the problems that the 2013 Aggregation Proposal is seeking to address. The lack of a meaningful opportunity to comment is contrary to the APA, which requires that notice of a proposed rule include "sufficient detail on its content and basis in law and evidence to allow for meaningful and informed comment."[7]

We respectfully request that the Commission consider the effectiveness of its existing and longstanding aggregation regime. After such consideration, any proposal to amend the Commission's aggregation requirements should clearly articulate specific inadequacies and shortcomings and should be narrowly tailored to avoid unnecessary and unjustifiable costs on the industry. The 2013 Aggregation Proposal falls well short of this standard.

II. The Commission's proposed aggregation regime is fraught with legal and policy flaws

The 2013 Aggregation Proposal is the progeny of aggregation rules that were adopted in November 2011 (subsequently vacated by a federal district court in September 2012)[8] and a proposal issued in 2012,[9] (for ease of reference, the Vacated Rules and 2012 Proposal are collectively referred to herein as the "Vacated and Proposed Rules" or "Vacated and Proposed Releases"). As set forth in greater detail in the 2013 Aggregation Proposal, the Commission's proposed aggregation regime consists of the following key features:

- **Owned Entity Aggregation Rules:**
    - Proposed rule 150.4(a)(1) includes rule text that is substantially similar to the text of current rule 150.4, requiring aggregation of "all positions in accounts for which any person . . . directly or indirectly . . . holds a 10 percent or greater ownership or equity interest."[10] As with the Vacated and Proposed Releases, the 2013 Aggregation Proposal invokes "long-standing" Commission administrative precedent[11] as justification for

[7] *See Am. Med. Ass'n v. Reno*, 57 F.3d 1129, 1132 (D.C. Cir. 1995).

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

[9] Aggregation, Position Limits for Futures and Swaps, 77 Fed. Reg. 31,767 (May 30, 2012) ("2012 Proposal").

[10] Proposed rule 150.4(a)(1) reads: "For the purpose of applying the position limits set forth in § 150.2, unless an exemption set forth in paragraph (b) of this section applies, all positions in accounts for which any person, by power of attorney or otherwise, directly or indirectly controls trading or holds a 10 percent or greater ownership or equity interest must be aggregated with the positions held and trading done by such person." 2013 Aggregation Proposal at 68,976.

[11] The Commission states that it "is proposing to adopt rule 150.4(b)(2), which is largely similar to proposed rule 151.7(b)(1). Proposed rule 150.4(b)(2) would continue the Commission's longstanding rule that persons with either an ownership or an equity interest in an account or position of less than 10 percent need not aggregate such positions solely on the basis of the ownership criteria, and persons with a 10 percent or greater ownership interest would still generally be required to aggregate the account or positions. However, rule 150.4(b)(2) would establish a notice filing procedure, effective upon submission, to permit a person with either an ownership or an equity interest in an owned entity of 50 percent or less to disaggregate the positions of an owned entity in specified circumstances, even if such person has a 10 percent or greater interest in the owned entity." 2013 Aggregation Proposal at 68,958.

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equating an ownership interest in a separately organized entity with an ownership interest in that entity's futures and swaps "positions in accounts."[12] Accordingly, unlike current rule 150.4, proposed rule 150.4(a)(1) not only would require a trader to aggregate the positions in accounts that the trader directly or indirectly owns or controls, but also the positions in accounts of any entity in which the trader directly or indirectly holds a 10 percent-or-greater ownership or equity interest (an "owned entity").[13]

- By way of example, under proposed rule 150.4(a)(1), in a corporate structure where entity A owns 10 percent of entity B, and entity B owns 10 percent of entity C , all futures and swaps positions held in C's accounts would be attributed upward from C to B, and all futures and swaps positions held in B's accounts, plus whatever B aggregated of C's positions, would be attributed upward from B to A, unless an exemption is available.[14] This upward attribution would hold even if A and B have no knowledge of or control over C's commodity interest trading and no financial or ownership interest in C's commodity interest accounts. Moreover, the attribution would not be the logical pro rata portion (i.e., 10 percent), which is the amount indirectly owned, but would be the entire position.
- The 2013 Aggregation Proposal would provide two limited exemptions to the proposed owned-entity aggregation requirement: (1) a trader with an ownership or equity interest of at least 10 percent but less than 50 percent of another entity under certain conditions[15] may claim an exemption by submitting a notice filing certifying the perfection of the exemption's conditions (proposed rule 150.4(b)(2)), and (2) a trader with an ownership or equity interest exceeding 50 percent under additional conditions[16] may request the Commission's approval of an application for aggregation relief (proposed rule 150.4(b)(3)).

[12] The 2012 proposed aggregation rules stated that in the context of applying the ownership prong to entities, "[s]mall ownership interests of less than 10 percent do not warrant aggregation. A 10 percent or greater ownership interest has served as a useful measure for aggregation, but the Commission has determined relief may be warranted for passive investments." 2012 Proposal at 31,775.

[13] *See* Vacated Rules at 71,651. (For ease of reference, the proposed requirement for a trader to aggregate the positions in accounts of an owned entity is referred to as the "Proposed Owned Entity Aggregation Requirement").

[14] *See* 2012 Proposal at 31,776.

[15] Under the 2013 Aggregation Proposal, the trader and the owned entity ("Related Entities") must not have knowledge of one another's trading decisions and have in place protections to ensure independence: (1) enforced written procedures to prevent sharing of trading information; (2) physical separations; (3) separately developed and independent trading systems; (4) no sharing of employees that control trading decisions; and (5) no sharing of risk management systems that permit sharing of trading information or strategies. *See* proposed rule 150.4(b)(2).

[16] The owning entity must, most importantly, certify that (1) the Related Entities' financial results are not consolidated in a financial statement pursuant to relevant accounting rules; and (2) each director for the owned entity certifies that (a) all of the owned entity's positions are bona fide hedging positions, or (b) the owned entity's positions do not exceed 20% of any position limit. Proposed rule 150.4(b)(3).

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- **IAC Exemption:** The proposed 150.4(b)(5) IAC aggregation exemption applies to "eligible entities."[17] Under the proposed IAC exemption, an "eligible entity" need not aggregate positions of customer accounts if: (1) the customer account is independently controlled, with no day-to-day direction from the eligible entity asset manager; and (2) the eligible entity has no more control than is necessary for a principal to fulfill the duty to supervise the trading activities consistent with fiduciary responsibilities and necessary to fulfill its duty to diligently supervise trading on its behalf. Additional conditions apply if the IAC is affiliated[18] with the eligible entity. In these cases, the affiliated persons must not have knowledge of one another's trading decisions and must have in place protections to ensure independence.[19]

- **"Substantially Identical Trading Strategies" Rule:** Proposed rule 150.4(a)(2) requires "any person that holds or controls the trading of positions in more than one account or pool with substantially identical trading strategies" to aggregate all such positions. The Aggregation Proposal further clarifies that this standard would trump any other exemption that could otherwise be applicable.

As discussed further below, if adopted, the above features of the proposed aggregation regime would be invalid under the APA because they are not in accordance with the law and are arbitrary and capricious. See APA Section 706(2)(A) (compelling a court to hold unlawful and set aside agency action that is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with the law").

A. The features of the proposed aggregation regime are not in accordance with the law

1. The proposed owned entity aggregation rules exceed the Commission's statutory authority

CEA section 4a(a)(1) of the Act, in relevant part, states that "[i]n determining whether [a trader] has exceeded [the Commission's] positions limits, the positions held . . . by any persons directly or indirectly controlled by [the trader] shall be included with the positions held . . . by such [trader]."[20] The 2013 Aggregation Proposal interprets this language as setting forth two independent bases for requiring aggregation of positions held by another person—"control" over that person or "ownership" of that person[21] (for ease of reference, we refer to these as the "control prong" and the "ownership prong," respectively). The control prong results from a plain reading of the statutory text—"any person directly or indirectly *controlled*" by a trader—while the ownership prong results from the Commission's *misreading* of the statute. By its terms, section 4a(a)(1) requires aggregation of positions held by another person where a trader directly or indirectly controls that other person, but it provides ***no basis***

[17] Proposed rule 150.1 defines "eligible entities" to include registered, 17 C.F.R. § 4.5 excluded, and 17 C.F.R. § 4.13 exempt commodity pools, in addition to commodity trading advisors, banks or trust companies, savings companies, insurance companies, or affiliates of any of the above.

[18] *See* Revision of Federal Speculative Position Limits and Associated Rules, 63 Fed. Reg. 38,525, 38,532 at n. 27.

[19] These include: (1) enforced written procedures to prevent sharing of trading information; (2) physical separations; (3) separately developed and independent trading systems; (4) separate marketing of trading systems; and (5) separate solicitation documents.

[20] 7 U.S.C. § 6a(a)(1).

[21] 77 Fed. Reg. at 68,951 (*citing* 77 Fed. Reg. at 31,773).

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for requiring aggregation of positions held by another person in the absence of such control of such other person.

In an attempt to support its misreading of section 4a(a)(1), the Commission cites past releases as administrative precedent, but none of those releases actually supports the Commission's proposed owned-entity requirement.[22] The Commission also invokes an explanation it provided in the 2012 Proposal: "[I]f the statute only required aggregation based on control, market participants may be able to use an ownership interest to circumvent aggregation in circumstances *where an ownership interest is used to directly or indirectly influence control* over the account or position."[23] Paradoxically, this explanation only justifies continued aggregation based on a trader having *direct or indirect control* over another person's trading. Finally, the Commission previously has explained that an ownership prong is necessary because aggregation based solely on a control prong is difficult to administer: "Absent aggregation on the basis of ownership, the Commission would have to apply a control test in all cases, which poses significant administrative challenges to individually assess control across all market participants." While administrative challenges are a necessary consideration in any rulemaking, they are not a basis for disregarding the plain language of the CEA.

2. <u>All of the features of the proposed aggregation regime are based on an inadequate cost-benefit analysis</u>

CEA section 15(a) requires the CFTC to consider and evaluate the costs and benefits of its proposed regulations. In contravention of its statutory obligation, the Commission has failed to adequately consider the costs and benefits of every aspect of its 2013 Aggregation Proposal. For example, the Commission fails altogether to consider the costs and benefits of the "substantially identical trading strategies" aggregation requirement for investments in funds that follow "substantially identical trading strategies," despite the very real costs that such a requirement would have on investors in multiple funds or, in particular, funds-of-funds and therefore liquidity in general.

Moreover, the Commission has failed to consider the practical challenges and costs and benefits of requiring DCMs and swap execution facilities ("SEFs"), without any discretion to do otherwise, to comply with aggregation rules that would have to "conform" with the CFTC's proposed aggregation rules. The accompanying "Position Limits for Derivatives" proposal requires DCMs and SEFs to implement aggregation standards for all derivatives—not just derivatives in the 28 physical commodities subject to federal position limits—which standards must "conform" to those in proposed 150.4.[24] That proposal together with the 2013 Aggregation Proposal would have a very serious impact on how DCMs conduct their activities across all derivatives markets. To provide a single example, DCMs administering aggregation rules conforming to the 2013 Aggregation Proposal's rules (presumably) would be responsible for receiving, validating, approving aggregation-related filings similar to those under proposed 150.5(c). These costs would be significant to DCMs, SEFs, and market participants and in markets that the Commission felt were low-risk enough not to be subjected to federally-administered position limits. These costs apparently never occurred to the Commission.

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[22] *See* discussion *infra* section B.2.

[23] 77 Fed. Reg. at 68,951 (*citing* 77 Fed. Reg. at 31,773).

[24] 78 Fed. Reg. at 75,757-58; proposed rule 150.5(a)(5).

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3. The proposed aggregation regime fails to take into account statutorily required factors

The Commission has failed to consider statutory factors it must consider in promulgating aggregation requirements that, as the Commission itself has acknowledged, are "an integral component that impacts the effectiveness" of the position limits regime the Commission is proposing in an accompanying release.[25] The accompanying position limits proposal seeks to impose federal speculative position limits under authority provided the Commission under CEA section 4a(a)(2).[26] According to that proposal, "the 'standards' the Commission must apply in imposing the limits required by section 4a(a)(2) of the [CEA] consist of the aggregation standard and the flexibility standard of CEA section 4a(a)(1)."[27]

Because the proposed aggregation requirement overlaps with the Commission's assertion of CEA section 4a(a)(2) authority, the statutory factors that apply to position limit rules promulgated under CEA section 4a(a)(2) apply to the proposed aggregation requirements as well. Congress directed the Commission, to the maximum extent practicable: (Factor 1) to diminish, eliminate, or prevent excessive speculation, (Factor 2) to deter and prevent market manipulation, squeezes, and corners, (Factor 3) to ensure sufficient market liquidity for bona fide hedgers, and (Factor 4) to ensure that the price discovery function of the underlying market is not disrupted.[28] The Commission is also (Factor 5) to "strive to ensure" that (Factor 5) trading on FBOTs in the same commodity will be subject to comparable limits, and (Factor 6) that any limits to be imposed by the Commission will not cause price discovery in the commodity to shift to trading on the FBOTs.[29]

If the Commission adopts the 2013 Aggregation Proposal without modification, the Commission, directly contrary to the direction of Congress, would ensure that FBOTs are **not** subject to comparable position limit rules and would encourage the migration of price discovery in the "same commodity," at the same and especially different delivery locations, to migrate to foreign markets. FBOTs that offer trading in the same commodity as those subject to the Commission's proposed federal position limits regime in the 2013 Limits NOPR currently apply a control-based aggregation policy and, under both Commission rules and the 2013 Aggregation Proposal, are not required to implement any specific aggregation requirements, even when they offer U.S. persons "direct access" to their trading platforms and offer "linked" contracts that are economically equivalent to contracts subject to U.S. position limits.[30] For example, ICE Futures Europe's position aggregation policy provides (emphasis added):

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[25] 78 Fed. Reg. at 75,681.

[26] *Id.* at 75,684.

[27] *Id.*

[28] CEA section 4a(a)(3)(B); 7 U.S.C. § 6a(a)(3)(B) (setting forth factors applicable when the Commission establishes position limits pursuant to CEA section 4a(a)(2)).

[29] *Id.* at 4a(a)(2)(C); 7 U.S.C. § 6a(a)(2)(C).

[30] In part 48 of its regulations, the Commission has implemented new registration authority over FBOTs that was provided in Dodd-Frank. More specifically, 17 C.F.R. § 48.8(c)(1)(ii)(A) requires FBOTs, as a condition of registration if they provide direct access to U.S. customers, to "[a]dopt position-limits (including related hedge exemptions)" for all contracts that are linked to those listed for trading on a registered entity, e.g., a DCM or a SEF). Notably absent from the conditions governing FBOT registration, though, is a requirement that an FBOT adopt position aggregation requirements similar to those imposed on DCMs and SEFs.

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> In addition to aggregating positions held by the same account across multiple members, the Exchange will also aggregate separate accounts or sub accounts under common ownership or control. This will mean that positions held by different business units within a client or member, or positions held by affiliate companies of a client or member, shall be aggregated and be subject to the normal position or expiry limits and accountability levels. **However, if such positions are independently controlled, then the positions will not be aggregated**.[31]

It can be expected that global enterprises with affiliates located across the globe, and that have physical commodity risk, would elect to hedge these risks in markets that are not subject to a strictly ownership-based aggregation requirement for the positions of owned entities, particularly if the physical commodity risks they face relate to a global commodity, e.g., crude oil, cotton, sugar, etc. The effect of a strictly ownership-based aggregation rule with respect to owned entities, therefore, would be to encourage the migration of liquidity and price discovery to FBOTs. That outcome is precisely what Congress sought to avoid in directing the Commission, in Factor 6, to "strive to ensure" that FBOTs do not become the central locus for price discovery of commodities subject to federal limits.

The absence of comparable position aggregation rules for FBOTs means that for physical commodity derivatives not subject to federal position limits, DCMs and swap execution facilities will have to impose aggregation requirements that extend to positions of owned entities, regardless of control, while FBOTs offering the same contract can apply less burdensome aggregation requirements. That outcome is precisely what Congress intended to avoid in directing the Commission, in Factor 5, to "strive to ensure" that trading on FBOTs in the same commodity will be subject to comparable limits.

Our concerns about the failure to "strive to ensure" that FBOT contracts are subject to comparable position limits rules affect both contracts that will be subject to the federal position limits regime and those contracts for which DCMs are to remain the primary position limits regulator. Under proposed 150.5(a)(5), the Commission proposes to require that DCMs impose aggregation rules that "conform" to the Commission's 150.4 rules.

The 2013 Aggregation Proposal does little better with its consideration of other factors. For example, the Commission's discussion of Factors 3 (ensuring sufficient market liquidity for bona fide hedgers) and 4 (ensuring that the price discovery function of the underlying market is not disrupted) is based on a premise that we demonstrated above as false, i.e. that "[p]rior rules required aggregation [of owned entity positions] at a 10 percent ownership level, so these regulations, which propose relief from aggregation at higher ownership levels, should lower the overall impact of aggregation on market quality factors without imposing unnecessary or inappropriate restrictions on trading."[32]

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[31] *See*, *e.g.*, Guidance: ICE Futures Europe Position and Expiry Limits and Accountability Levels, *available at* https://www.theice.com/publicdocs/circulars/13158%20attach%201.pdf (Nov. 2013). ICE Futures Europe offers for trading on its FBOT platform several contracts that are in the "same commodity" as those subject to the limits proposed in the Commission's 2013 Limits NOPR, e.g., NYMEX Light, Sweet Crude Oil, NYMEX Heating Oil, NYMEX RBOB Gasoline, and CBOT Soybean. *See id*.

[32] 78 Fed. Reg. at 68,972.

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B. The features of the CFTC's proposed aggregation regime are arbitrary and capricious for a number of reasons

Normally, an agency rule would be arbitrary and capricious if the agency has relied on factors which Congress has not intended it to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise. *See Motor Vehicle Manufacturers Ass'n v. State Farm Mutual Automobile Insurance Co*., 463 U.S. 29, 43 (1983).

Courts have found an agency to have acted arbitrarily and capriciously when: an agency does not provide a meaningful opportunity for comment, *see, e.g.*, *North Carolina Growers' Ass'n, Inc. v. United Farm Workers*, 702 F.3d 755 (4th Cir. 2012) (agency stated that comments regarding the substance and merits of a rulemaking would not be considered); an agency fails to make available the information upon which it based its proposed rules, *see, e.g., Am. Radio Relay League, Inc. v. FCC*, 524 F.3d 227 (D.C. Cir. 2008) (agency redacted relevant portions of the studies upon which it relied, thereby depriving interested persons of the opportunity to comment); an agency relies on a mischaracterization of its precedent, *see, e.g., Sierra Club v. Jackson*, 833 F. Supp. 2d 11, 33 (D.D.C. 2012) (agency "failed . . . to come to grips with its prior precedents"); and an agency adopts a final rule that is not a logical outgrowth of the proposed rule, *see, e.g.*, *CSX Transp. Inc. v. Surface Transportation Board*, 584 F.3d 1076 (D.C. Cir. 2009) (the agency's proposed rule would have considered data from the previous year, while the agency's final rule considered the past four years of data).

For the reasons discussed below, the CFTC's proposed aggregation rules are arbitrary and capricious.

1. Failure to provide a meaningful opportunity to comment

As noted above in Part I of this letter, the failure to provide a meaningful opportunity to comment on a notice of proposed rulemaking is contrary to the APA. Indeed, such failure is one of the hallmarks of an arbitrary and capricious agency action. Here, the Commission has failed to provide a meaningful opportunity to comment on its 2013 Aggregation Proposal by not identifying any basis or justification for the various features of the proposed aggregation regime. For example, with respect to the IAC exemption, the CFTC asserts that its amended IAC exemption "is substantially similar" to the existing IAC exemption, but provides no rationale for the proposed amendments to the IAC exemption or for other amendments.[33]

Similarly, the rationale behind the proposed "substantially identical trading strategies" rule is not discussed in the 2013 Aggregation Proposal nor in its 2012 predecessor. The Commission's 2011 "Position Limits for Futures and Swaps" final rulemaking stated that a similar requirement for funds with "identical trading strategies" was "intended to prevent circumvention of the aggregation requirements. In [the] absence of such [an] aggregation requirement, a trader can, for example, acquire a large long-only position in a given commodity through positions in multiple pools, without exceeding the applicable position limits."[34] Moreover, the 2013 Aggregation Proposal provides no guidance as to the meaning of

[33] Other unjustified amendments include the requirement to submit a notice filing under proposed rule 150.4(c)(1).

[34] Position Limits for Futures and Swaps, 76 Fed. Reg. 71,626, 71,654 (Nov. 18, 2011).

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"substantially identical trading strategies," nor did the Commission explain how the term is to be distinguished from "identical trading strategies" used in the vacated Part 151 rules. Ultimately, the failure to clearly describe and provide a rationale for the proposed aggregation requirements makes it impossible to properly comment on them.

2. Reliance on mischaracterization of precedent

Two aspects of the Commission's 2013 Aggregation Proposal in particular are based on a mischaracterization of the CFTC's own precedent: (1) the proposed owned entity aggregation rules, and (2) the limitation of the IAC exemption to client accounts. Agency actions based on a mischaracterization of the agency's own precedent are arbitrary and capricious under the APA.[35]

In *National Federal Employees Federation v. Federal Labor Relations Authority*, the D.C. Circuit determined that the Federal Labor Relations Authority (FLRA) acted arbitrarily and capriciously by upholding a decision of the Bureau of Land Management on the basis of a "revisionist view" of the FLRA's precedent that found no credence in the cases cited by the FLRA.[36] Similarly, the Environmental Protection Agency (EPA) in *Sierra Club v. Jackson*, was found to have acted arbitrarily and capriciously by "fail[ing] . . . to come to grips with its prior precedent" in issuing a stay of two of its rules.[37] Although the EPA contended that it had never relied on a four-factor test before staying its rules, the court determined that the EPA's claim was refuted by the prior statements of the agency itself.[38] The Food and Drug Administration (FDA) in *Prevor v. Food and Drug Administration*, likewise was determined to have acted arbitrarily and capriciously by basing a product classification decision on an "even in part" standard that it claimed was not new, but that actually marked a departure from the FDA's prior precedents and the relevant statute.[39] According to the court, that the FDA issued new draft guidance documents that included this "even in part" standard only undermined the FDA's assertion that its approach was not new.[40]

Like the agencies in the above cases, the Commission has "failed . . . to come to grips with its prior precedent" and instead has taken a "revisionist view" of that precedent in its aggregation proposal, which would be grounds for a court to find an arbitrary and capricious agency action. The following sub-

[35] *See National Federation of Federal Employees v. Federal Labor Relations Authority*, 412 F.3d 119 (D.C. Cir. 2005) (challenge to agency decision based on agency's "revisionist view" of its precedent); *Reno-Sparks Indian Colony v. Environmental Protection Agency*, 336 F.3d 899 (9th Cir. 2003) (challenge to agency rule based on agency's purported mischaracterization of its prior precedent); *Sierra Club v. Jackson*, 833 F. Supp. 2d 11 (D.D.C. 2012) (challenge to agency decision that departed from agency's precedent without explanation and that agency defended by mischaracterizing its precedent); *Prevor v. Food and Drug Administration*, 895 F. Supp. 2d 90 (D.D.C. 2012) (challenge to agency decision based on agency's mischaracterization of its prior precedents and statute).

[36] *See id.* at 123-24 (noting that whereas the FLRA "now claims that it has always viewed proposals that would require work by agency personnel as interfering with the right to assign work . . . ," *id.* at 123, the FLRA's "past decisions have found interference with the right to assign work only when the proposal would restrict who performs a task or when a task may be performed . . .").

[37] 833 F. Supp. 2d 11, 33. (D.D.C. 2012).

[38] *See id.* at 32.

[39] 895 F. Supp. 2d 90 (D.D.C. 2012).

[40] *See id.* at 100-01.

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sections specifically show how the Commission has mischaracterized its own precedent relating to the owned entity aggregation rules and the IAC exemption.

a. Owned entity aggregation rules

The Commission asserts that applicable CFTC precedent (including the current aggregation rules) requires aggregation ***solely on the basis of ownership or equity interest in an entity***. However, consistent with the CEA, the CFTC's precedent (including existing rules) does not require a trader having an ownership or equity interest in an entity to aggregate the owned entity's positions solely on the basis of that ownership or equity interest. Rather, the CFTC's precedent recognizes two aggregation triggers, described further below: i) ownership of an account, as opposed to an entity, and ii) trading control.

(i) Ownership of an account

The Commission's precedent considers a 10 percent or more ownership or equity interest in an *account* to constitute "a financial interest tantamount to ownership" of positions in that account and an indicia of trading control.[41] But the Commission in the vacated and proposed rules, as well as the 2013 Aggregation Proposal, consistently and erroneously recounts that precedent as applying to ownership interests in *entities* and as a sufficient basis for requiring aggregation. The Commission, in effect, has adopted a revisionist view of the term "account," equating the term account with entity.

Under the CFTC's precedent relating to the term "account," however, an "account" has never referred to an owned entity that itself has accounts. For example, the Commission's 1979 Statement of Aggregation Policy ("1979 Policy Statement"), which forms the foundation of the Commission's current rules,[42] is squarely focused on ownership of accounts and interests in pools, not ownership in entities that have accounts.[43] It provided that "[e]xcept for a limited partner or shareholder in a commodity pool, any person who has a 10 percent or more financial interest *in an account* will be considered as an account controller."[44] The 1979 Policy Statement defined "discretionary account" as "a commodity futures trading account for which buying and/or selling orders can be placed or originated, or for which transactions can be effected . . ." Nothing in the 1979 Policy Statement suggests the Commission contemplated a definition of "account" that suggested anything more than a personally owned futures trading account.

Similarly, a CFTC rulemaking from 1999 ("1999 Revisions"), which the Commission quotes in an attempt to support its proposed owned entity aggregation rules, does not bolster the Commission's revisionist interpretation of the term "accounts." The 1999 Revisions were focused entirely on the aggregation of directly owned accounts—the revisions had nothing to do with accounts held by an owned entity.[45]

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[41] 2013 Aggregation Proposal at 68,946.

[42] The 1999 rules codified the 1979 Statement on Aggregation Policy. 1999 Revisions at 24,043.

[43] Statement of Policy on Aggregation of Accounts and Adoption of Related Reporting Rules, 44 Fed. Reg. 33,839 (Jun. 13, 1979).

[44] *Id.* at 33,845 (emphasis added).

[45] 78 Fed. Reg. at 68,956 (*quoting* 1999 Revisions at 24,046).

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In fact, the Commission's 1999 Revisions rulemaking confirms that the meaning of "account" encompasses only personally owned or controlled accounts. In that rulemaking, the Commission emphasized that "[c]ompliance with the Commission's speculative position limit rules is often dependent upon the proper aggregation of positions. A central feature of the proposed rules is the codification of the aggregation standard itself. As the Commission stated in the notice of proposed rulemaking, the requirements relating to aggregation of positions, including the exceptions provided in the 1979 Policy Statement currently are included implicitly in the Commission's large-trader reporting rules."[46] The large-trader reporting system, in turn, aggregates positions at the ***personal or entity level***, not the enterprise level. For example, rule 17.00(b) requires that FCMs aggregate multiple personally owned or controlled accounts, i.e. the positions of any "person" if that "person holds or has a financial interest in or controls more than one account," for the purpose determining whether that "person" holds a position in excess of a reporting level.[47] Rule 17.00(b)(3) confirms that aggregation in the position limits context works in same way: "[m]ultiple accounts owned by a trader shall be considered a single account as provided under §§150.4(b), (c) and (d) of this chapter." Finally we note that Rule 18.04(b) (relating to the Form 40, a key component of the large trader reporting system) distinguishes between owners of the "reporting trader" from owners in the "accounts of the reporting trader" as well—providing further support to the conclusion that the Commission's aggregation rules have traditionally aggregated accounts at the personal or entity level, not at the enterprise level.

The 2013 Aggregation Proposal cites the term "proprietary account" in 17 CFR 1.3(y) as support for the owned-entity aggregation standard.[48] The "proprietary account" definition, however, when carefully parsed, further proves the point that "account" in the Commission's rules generally refers to personally owned or controlled accounts. Although the term is not entirely relevant to the position limits context,[49] the fact that the term "proprietary account" is explicitly defined to extend to accounts held by "business affiliates" confirms that the Commission's use of the term "account," standing alone, should not be used to include an owned entity that itself has accounts.[50]

(ii) Trading control

Without a beneficial interest in an account, a trader must have control in order to trigger the aggregation requirements under the Commission's existing position aggregation rules. The Commission

[46] *Id.* at 24,043 (*citing*, *e.g.*, 44 Fed. Reg. at 83,839).

[47] It should be noted that current rule 18.04 and current Form 40 (also parts of the large trader reporting system) collect limited information on the direct owners of an entity. Rule 18.04(b) distinguishes between beneficial owners in the "reporting trader" from beneficial owners in the "accounts of the reporting trader" as well. Entity ownership information has been and should be used for surveillance purposes, and if necessary, may be used to support account and position aggregation determinations. However, this information has never been used as the sole basis for forcing the aggregation of positions between affiliated entities.

[48] 78 Fed. Reg. 68,946 at 68,956.

[49] One regulation in which the term "proprietary account" is used, for example, is Commission regulation 155.3, which requires that an FCM give priority to executing customer orders over orders from any "proprietary account." 17 C.F.R. § 155.3.

[50] Furthermore, for the purpose of a lower tier entity's account as the proprietary account of a higher tier entity, not only must a higher tier owning entity carry an owned-entity's commodity futures account on its books and records, but there must also be a control relationship between the entities beyond mere ownership.

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has traditionally interpreted "control" in CEA section 4a(a)(1) and its predecessors as control of trading, not as corporate control that would arise from some degree of ownership or equity interest or any other type of control that would be irrelevant in the context of commodity derivatives trading. For example, the CFTC defines a "controlled account" in 17 C.F.R. 1.3(j) as "an account . . . controlled by a person *if such person by power of attorney or otherwise directs trading for such account*." (emphasis added)

Current rule 150.4(c) best demonstrates that, contrary to the CFTC's claims in its 2013 Aggregation Proposal, ownership of an entity or some form of corporate control alone is not a trigger for aggregation. Under current rule 150.4(c), a corporate parent of a wholly-owned commodity pool operator ("CPO") would not be required to aggregate any positions [held or] controlled by the CPO (an owned-entity of the corporate parent) solely because of the parent's ownership interest in the owned-entity. In other words, current rule 150.4, which has long implemented the aggregation requirement in CEA section 4a(a)(1), does not require (and has never required) the aggregation of an owned-entity's positions based solely on a trader having an ownership or equity interest in an owned entity.

Furthermore, current rule 150.4(b) generally exempts a commodity pool's participants with an ownership interest of 10 percent or greater from aggregating the positions held by the pool.[51] In fact, the only situations in which this exemption would not apply is where the Commission has identified some "plus factors" that would suggest the participant has some amount of control over the pool's trading (e.g., the participant is affiliated with, or a principal of, the pool's CPO).[52]

Crucially, the aggregation requirement in current rule 150.4(c)(2) is not triggered solely by an investor's acquisition of a 10 percent or greater ownership interest in a commodity pool. Rather, under current rule 150.4(c)(2), it is the existence of a 10 percent or greater ownership interest in a commodity pool *plus* an affiliation with the pool's CPO that triggers an aggregation requirement.[53]

The chart below illustrates a scenario in which a parent corporation, as principal to the wholly-owned CPO, would not need to aggregate the positions the wholly-owned CPO controls (without giving effect to the IAC exemption):

[51] *See* 17 C.F.R. § 150.4(b).

[52] "Affiliated companies are generally understood to include one company that owns, or is owned, by another, or companies that share a common owner."63 Fed. Reg. at 38,532 n. 27. Under rule 3.1(a)(2)(ii), principals include entities that have a direct ownership interest that is 10 percent or greater in a lower tier entity, such as the parent of a wholly-owned subsidiary. Accordingly, the corporate parent of a wholly-owned CPO would be affiliated with, and a principal of, its wholly-owned subsidiary.

[53] 150.4(c)(2) provides that "a principal or affiliate of the operator of the pooled account must aggregate the pooled account or positions with all other accounts or positions owned or controlled by that trader, provided, however, that the trader need not aggregate such pooled positions" if indicia of trading independence are present, i.e. "(i) [t]he pool operator has, and enforces, written procedures to preclude the trader from having knowledge of, gaining access to, or receiving data about the trading or positions of the pool; (ii) the trader does not have direct, day-to-day supervisory authority or control over the pool's trading decisions; and (iii) the trader, if a principal of the commodity pool operator, maintains only such minimum control over the commodity pool operator as is consistent with its responsibilities as a principal and necessary to fulfill its duty to supervise the trading activities of the commodity pool."

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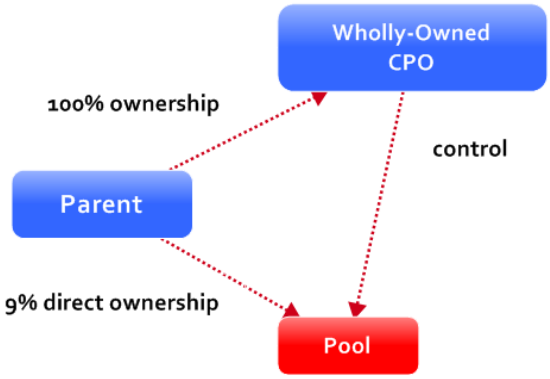

Notably, an ownership interest in either the commodity pool or in a CPO, without more, is not sufficient to require aggregation of the pool's positions or the CPO's controlled pool positions to its corporate parent.

Not surprisingly, the other position aggregation provisions of part 150 operate under the same principles. For example, under current rule 150.3, an eligible entity's mere corporate ownership of an affiliated[54] independent account controller ("IAC") does not trigger a requirement for the eligible entity to aggregate the positions controlled by the IAC.[55] Likewise, an FCM under rule 150.4(d) is required to aggregate positions held by an affiliated entity when the affiliate carries the FCM's discretionary account.[56]

Even the Commission's enforcement history reflects that it has traditionally viewed aggregation of owned entity positions as only being required where there is common trading control. For example, in *In the Matter of Vitol Inc. et al.*, the Commission settled an administrative enforcement action against Vitol Inc. ("Vitol") and Vitol Capital Management ("VCM") for false statements in connection with NYMEX position aggregation rules (which parallel Commission rules, see CME Rule 559.D.2, available at http://www.cmegroup.com/rulebook/CME/I/5/5.pdf).[57] The Commission's Order focused on Vitol and VCM's failure to disclose information relating to the "flow of trading information between" the affiliated entities and the "limited nature of the barriers to trading information flow between" these presumably

[54] "Affiliated companies are generally understood to include one company that owns, or is owned by, another or companies that share a common owner." 63 Fed. Reg. at 38,532 n. 27.

[55] 17 C.F.R. § 150.3(4)(i) (providing for disaggregation relief for eligible entities that are "affiliated entities" of eligible entities under certain conditions indicative of a lack of common trading control, e.g., "separately-developed and independent trading systems.").

[56] FCMs and their affiliates must aggregate the positions "held" (i.e., owned) in a "discretionary account" (defined as a "commodity futures trading account for which buying and/or selling orders can be placed or originated, or for which transactions can be effected . . ."), an account they "participate[] in," or accounts in which they offer trading advice (i.e. exert some control over) unless the accounts are controlled independently of any account in which the FCM and their affiliates have a 10 percent or more financial interest (and are demonstrated as being independently managed through the demonstration of three factors). 17 C.F.R. § 150.4(d).

[57] *See* In the Matter of Vitol Inc. et al., Docket No. 10-17 (CFTC Sept. 14, 2010), available at http://www.cftc.gov/ucm/groups/public/@lrenforcementactions/documents/legalpleading/enfvitolorder091420100.pdf.

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commonly owned Vitol affiliates. These facts would have been relevant only if common control were a pre-condition to the application of position aggregation. If ownership alone sufficed to require aggregation, the facts set forth in the Commission's Order would have been irrelevant for assessing liability. Notably, no ownership related facts were presented in the Order. In this matter, the Commission found that Vitol and VCM willfully failed to correct NYMEX's misperception of the "true nature of the relationship between" Vitol and its VCM and imposed a civil monetary penalty of $6 million.

More recently, in *In the Matter of Citigroup Inc. et al.*, the Commission aggregated the positions of two wholly-owned subsidiaries with the positions of a their common corporate parent, but not solely on the basis of corporate ownership alone.[58] The facts of that action reflect a financial structure where the entities operated as swap dealers off-setting the same risk acquired from similarly situated counterparties. In addition, the Commission found that the subsidiaries traded as agents for the corporate parent. Accordingly, corporate ownership was not used by the Commission as a sufficient basis for aggregating positions but as an indicia of control.

Ultimately, requiring the aggregation of owned entities' positions based on common ownership alone is contrary to administrative precedent and the CEA.

b. IAC exemption

As for the IAC exemption, the Commission states that, under its longstanding interpretation of that exemption, the exemption is limited to providing disaggregation for "customer" positions traded by IACs. However, the Commission's precedent relating to the IAC Exemption, since at least 1999, actually contains no such limitation.

In 1999, the Commission amended rule 150.4 to disqualify limited partners, with a 25 percent or greater interest in a commodity pool operated by a CPO exempt from registration under rule 4.13, from disaggregating the positions of the pool from the limited partner's other positions.[59] Proprietary investors have long used limited partnership interests in commodity pools to gain financial exposure to the futures markets. To ameliorate the new rule's impact on investors, in 1999, the Commission simultaneously expanded the definition of eligible entity to include limited partners. By doing so, the Commission gave such investors the ability to disaggregate as eligible entities by perfecting an IAC exemption. When the Commission expanded the definition of eligible entity to include limited partners, it did so while explicitly understanding that the proprietary funds of affiliates or principals of an owned-CPO (i.e., the proprietary funds of owning entities that could qualify as eligible entities) may be used to invest in pools operated by an owned-CPO.[60] Thus, the assertion that a long-standing position restricts the IAC exemption to an "eligible entity's client positions or accounts" is erroneous.

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[58] *See* In the Matter Citigroup Inc. et al., Docket No. 12-34 (CFTC Sept. 21, 2012), available at http://www.cftc.gov/ucm/groups/public/@lrenforcementactions/documents/legalpleading/enfcitigroupcgmlorder092112.pdf.

[59] In 1999, the Commission expanded the definition of "eligible entity" to include certain limited partners without limiting the IAC to customer accounts. By doing so, the Commission gave such investors the ability to disaggregate positions in a pool by perfecting an IAC exemption. *See* 1999 Revisions at 24,045.

[60] 1999 Revisions at 24,045.

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In addition to limited partners, the Commission in 1999 extended eligibility for the IAC exemption by defining banks, trust companies, savings associations, insurance companies and their separately incorporated affiliates as eligible entities.[61] Although such entities have customers, their use of futures will not necessarily involve customer funds. [The Commission expressed restriction limiting the IAC exemption purely to customer funds when it expanded the eligible entity definition to series of non-money managers. Instituting such a restriction contravenes a fundamental of purpose of the IAC exemption, which is to demonstrably separate control from ownership.]

Thus, contrary to the Commission's revisionist view of its precedent, the 1999 Revisions to part 150 demonstrate that the definition of eligible entity was expanded to include entities that would use the IAC Exemption to disaggregate proprietary investments.

3. Creation of absurd consequences

The "substantially identical trading strategies" rule would result in absurd and draconian consequences, well in excess of what would be needed to prevent any circumvention. Under this proposed rule, a retail investor that invests $10,000 in two $1 billion single-commodity index funds using the same index would have to aggregate the derivatives positions of the two $1 billion funds because they follow "substantially identical trading strategies."

The proposed rule applies even when the investor in funds with "substantially identical trading strategies" is unaware of how his or her money is specifically invested. For example, an investor in two fund-of-funds who invests $10,000 in each fund that, in turn, invest that $10,000 in two $1 billion single-commodity index funds that follow "substantially identical trading strategies" would have to aggregate the positions of the two $1 billion single-commodity index funds—even if the investor did not know how the fund-of-funds managers allocated the investor's money.

III. Conclusion

While we share the Commission's mission to combat price manipulation and other disruptions to the integrity of commodity prices, we do not believe the proposed aggregation rules further this mission at all. Moreover, we believe that the proposed aggregation rules would impose serious negative consequences for U.S. derivatives markets and market participants. Because, as discussed in further detail above, the existing position aggregation regime has not been shown to be ineffective in any way and the proposed aggregation regime suffers from serious legal and policy flaws, we recommend that the Commission decline to adopt the 2013 Aggregation Proposal on aggregation.

* * * *

CME Group thanks the Commission for the opportunity to comment on this Proposal. Should you have any comments or questions regarding this submission, please contact me by telephone at (312) 930-3488 or by e-mail at Kathleen.Cronin@cmegroupcom; Thomas LaSala, Managing Director, Chief Regulatory Office by telephone at 212-299-2897 or via email at Thomas.LaSala@cmegroup.com or Bruce Fekrat, Executive Director and Associate General Counsel by telephone at (212) 299-2208 or by e-mail at Bruce.Fekrat@cmegroup.com.

[61] *Id.* at 24,046.

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