CENTER FOR CAPITAL MARKETS COMPETITIVENESS

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February 10, 2014

Ms. Melissa Jurgens
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

RE: Comments on Proposed Position Limits for Derivatives and Proposed Aggregation of Positions; RIN 3038-AD99 and RIN 3038-AD82

Dear Ms. Jurgens:

The U.S. Chamber of Commerce ("Chamber") is the world's largest business federation representing over three million companies of every size, sector, and region. The Chamber created the Center for Capital Markets Competitiveness ("CCMC") to promote a modern and effective regulatory structure for capital markets to fully function in a 21st century economy. The CCMC welcomes this opportunity to provide comment on the Notice of Proposed Rulemaking issued by the Commodity Futures Trading Commission (the "Commission" or "CFTC") on December 12, 2013 regarding Position Limits for Derivatives (the "PL Proposal").[1]

The PL Proposal imposes limits on 28 physical commodity futures contracts (referred to as "Core Referenced Futures Contracts") as well as futures, options, and swaps that are economically equivalent to Core Referenced Futures Contracts (collectively, "Referenced Contracts"). CCMC also welcomes the opportunity to provide comment on the Commission's Notice of Proposed Rulemaking regarding Aggregation of Positions published on November 15, 2013 (the "Aggregation Proposal").[2] The Aggregation Proposal modifies the aggregation policy under the

[1] *See* Proposed Rule, Position Limits for Derivatives, 78 Fed. Reg. 75,680 (Dec. 12, 2013).
[2] *See* Proposed Rule, Aggregation of Positions, 78 Fed. Reg. 68,946 (Nov. 15, 2013).

Commission's position limits regime for futures and options for nine agricultural commodities and would also apply to the Referenced Contracts if the Commission finalizes both the PL Proposal and the Aggregation Proposal.

In brief, the PL Proposal proposes spot month position limits that will generally be based on 25 percent of deliverable supply of the underlying commodity.[3] The CFTC proposes to set the initial limits for Referenced Contracts at levels currently set by the designated contract market ("DCM") that lists the Core Referenced Futures Contract, and also requests comment on alternative levels, including those provided by the CME Group.[4] Non-spot month position limits under the PL Proposal would apply to all positions in all contract months combined or in single contract months, and would generally be set at 10 percent of the contract's first 25,000 of open interest and 2.5 percent thereafter, but will initially be based on open interest in futures and swaps that are significant price discovery contracts.

The Aggregation Proposal would adopt the Commission's general aggregation rule, which requires a person to aggregate positions in which the person has a 10 percent or greater ownership interest as well as positions that such person controls. The Aggregation Proposal includes additional exemptions for certain owned-entities, broker-dealers and underwriting.

The CCMC supports the Commission's fundamental goals of preventing price manipulation and protecting the integrity of the derivatives markets. We also commend the Commission's work in implementing the Dodd-Frank Act to promote transparency and to reduce systemic risk in the derivatives markets. However, we have significant concerns about certain aspects of the PL Proposal and the Aggregation Proposal, including the following:

- The PL Proposal fails to utilize current, forward-looking data and other empirical evidence to set position limits;
- The Commission has faced serious challenges in collecting, storing, and analyzing swap data, which may compromise the Commission's ability to set limits properly;

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[3]Under the PL Proposal, spot month position limits are applied separately for physically-delivered and cash-settled contracts.

[4]PL Proposal, 78 Fed. Reg. at 75,769.

- The PL Proposal would result in decreased liquidity and transparency in the markets and impose unnecessary and unwarranted limits on a market participant's ability to hedge their risks within the energy, metals and agricultural derivatives markets;
- The PL Proposal's narrow treatment of the bona fide hedging definition would seriously limit commercial end-users ability to hedge legitimate price risks arising from normal business operations; and
- The Aggregation Proposal's requirement that entities claiming the "owned entity" exemption must first submit an application to the Commission for prior approval is unworkable.

Failure to Utilize Current, Forward-looking Data and Other Empirical Evidence

The CCMC has serious concerns about the integrity of a position limits rulemaking that fails to utilize current data and other empirical evidence in setting the position limits set forth in the PL Proposal. The Commission must take time to gather and analyze usable information on the swaps markets before it can correctly set limits for these markets. Such data —which is being reported currently— is necessary to provide a comprehensive understanding of the swaps markets and individual trader positions.

Although the PL Proposal cites 132 studies, it notably explains that "these studies overall show a lack of consensus regarding the impact of speculation on commodity markets and the effectiveness of position limits."[5] In fact, the PL Proposal cites only two examples to support its assertion that position limits have prevented market disruption, and one is more than thirty years old.[6] Despite this clear lack of consensus or justification, the Commission continues to rely on soft, stale data without regard for potential market disruptions that may result from the use of such data explaining,

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[5]Id. at 75,695.

[6]*See* id. at 75,695-96. *See* also Dissenting Statement of Commissioner Scott D. O'Malia, id. at 75,841 ("I am troubled that the [PL Proposal] uses only two examples from the past—one of them as far back as the 1970s—to cobble together a weak, after-the-fact justification that positions limits would have prevented market disruption. This is glaringly insufficient. Instead, the Commission should have taken the time to analyze the new data, especially from the swaps market, that has been collected under the Dodd-Frank Act.")

"[w]hile there is not a consensus, the fact that there are studies on both sides, in the Commission's view, warrants erring on the side of caution."[7]

Under the new reporting rules set forth in Title VII of the Dodd-Frank Act and the CFTC's regulations, the CFTC will continue to obtain current market data with which it can perform an analysis on such current swap market data. It is troubling that the PL Proposal declines to use current swap market data when determining whether limits are necessary and, if so, at what levels. Under these circumstances, setting positions limits based on old data constitutes arbitrary and capricious decision-making.

While the CCMC is not opposed to position limits that are determined to be necessary and appropriate, the Commission should not impose a position limit regime without concrete, current economic evidence that excessive speculation exists, that it leads to distortion in commodity prices, and that the position limits will solve the problem. Such an undertaking cannot be accomplished accurately or effectively without reviewing and analyzing current data on the swaps markets.

Commission Should Ensure that Data is Accurate Prior to Setting Position Limits

As discussed, we urge the Commission to reconsider and re-propose the limits set forth in the PL Proposal after it has analyzed current market data; however, it is imperative that the Commission ensure that the data it is analyzing is accurate and reliable. Reliance on inaccurate or unreliable data greatly compromises the Commission's ability to set and maintain position limits, while potentially harming market liquidity and increasing costs. We note that footnote 428 of the PL Proposal explains the unreliability of data collected pursuant to the CFTC's Part 20 large trader reporting, explaining that "[s]everal reporting entities have submitted data that contained stark errors."[8] Further, there are concerns about the quality of swap data reported to swap data repositories via Parts 45 and 46 of Commission's regulations. Commissioner O'Malia has explained "how important it is for the Commission to improve [its] data

[7] Id.
[8] Id. at 75,734, n. 428.

quality so it can have an accurate and complete picture of the swaps market."[9] He further explained that the Commission's "ability to perform risk assessments and market oversight will hinge on the quality of [its] data."[10]

Recognizing the deficiencies in swap data that is currently being collected and available to the CFTC, the CFTC announced on January 21, 2014 that it will form an interdivisional working group to review regulatory reporting. Specifically, the Commission explained that the working group will take on a number of tasks "[a]s part of the Commission's ongoing efforts to improve swap transaction data quality and therefore improve the Commission's ability to utilize the data for analysis and other regulatory purposes."[11]

We applaud the Commission's efforts to ensure accuracy and quality of swap data and, given the noted struggles with data quality, we recommend that the Commission analyze current swap data to determine if position limits are appropriate only after the interdivisional working group has an opportunity to provide recommendations to the Commission and the Commission an opportunity to implement such recommendations, as appropriate. This will ensure that the Commission is relying on accurate, current data when determining and reviewing the appropriateness of position limits.

<u>Decreased Liquidity and Increased Costs</u>

Section 4a(a)(3)(B)(iii) of the Commodity Exchange Act ("CEA") mandates that in establishing position limits, the Commission must, to the maximum extent practical, "ensure sufficient market liquidity for bona fide hedgers" and "ensure that the price discovery function of the underlying market is not disrupted." Liquidity is essential to prevent a decrease in market size, which in turn increases market volatility and costs to businesses, farmers, and individuals attempting to manage their risks. The PL Proposal, and its reliance on a one-fize-fits-all approach and stale data that is not indicative of current market conditions, would likely raise the costs to participate in these markets, which would have the effect of decreasing the number of market participants. With

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[9]Keynote Address by Commissioner Scott D. O'Malia, State of the Industry 2014 Conference, Commodity Markets Council (Jan. 27, 2014), *available at* http://www.cftc.gov/PressRoom/SpeechesTestimony/opaomalia-32.
[10]Id.
[11]CFTC Release: PR6837-14, "CFTC to Form an Interdivisional Working Group to Review Regulatory Reporting" (Jan. 21, 2014).

fewer market participants and increased costs, there likely would be less market liquidity, which could impair the price discovery process and result in higher volatility. While some have accused speculators of causing financial distress, speculators actually provide very valuable services to derivatives markets by playing a crucial role in facilitating the transfer of risk from commercial participants by providing liquidity and by contributing to price discovery.

The PL Proposal not only fails to consider current data when setting position limits, it also disregards existing studies and empirical evidence that hard position limits will not reduce price volatility or prevent market manipulation. If position limits, such as those in the PL Proposal, are implemented without a full analysis of current market data, markets will likely be distorted and costs to hedgers increased. Further, participation in various markets will likely decrease. Such results would lead to less liquidity in markets, which would increase market volatility and costs to businesses, farmers and individuals attempting to manage their risks.

Deliverable Supply

Estimated deliverable supply, which is used for setting both DCM and CFTC spot-month limits, must have a reasonable correlation to actual deliverable supplies. We note that the Commission has not approved new estimates of deliverable supply for many commodity contracts covered by the PL Proposal, in some cases for over a decade. The Commission explains "that many market participants are already used to these levels," however, the Commission does not address the fact that these levels may not represent current market data or conditions. For example, estimated deliverable supply for natural gas and crude oil, as reflected by the CFTC endorsed spot-month limits, does not take into account the expanded storage, pipeline network, and production facilities that have radically changed these markets since the 1990s. More specifically, deliverable supply data for natural gas has not been updated since 1996 despite the fact that the natural gas sector has experienced dramatic changes in exploration and significantly increased production in recent years. Similarly, grain and oilseed production and delivery channels continue to evolve as new technologies increase production and growing demand for biofuels and protein in export markets shift consumption patterns.

Relying on current data and market conditions, the Commission must update its estimated deliverable supply and spot month limits to reflect today's cash markets. Not doing so, while restricting hedging exemptions for commercial entities and arbitrarily establishing a five times higher spot month limit for financial settled contracts, will damage the price discovery function of physically settled futures to the detriment of commercial end-users and consumers.

Bona Fide Hedging

The PL Proposal sets forth new regulations that would narrow the existing bona fide hedging definition by doing away with CFTC regulation 1.3(z),[12] making it more difficult for commercial end-users to hedge legitimate price risks that arise in the normal course of business. In particular, the restricted definition of bona fide hedging in the PL Proposal greatly affects hedgers who use physical-delivery Referenced Contracts to hedge their risk. Specifically, the PL Proposal does not permit the following enumerated hedges for physical delivery Referenced Contracts if they are held during the earlier of the last five days of trading or the spot month in the physical delivery Referenced Contract: hedges of unsold anticipated production; hedges of offsetting unfixed price cash commodity sales and purchases; hedges of anticipated royalties; hedges of services; and cross-commodity hedges. For example, under the PL Proposal, a grain elevator would not be permitted to hedge routine anticipated cash flow price risk. Further, the PL Proposal's bona fide hedging definition hits hedgers who use physical-delivery futures to hedge their risk particularly hard, as it could reduce their sales options and diminish futures-cash market price convergence.

Through the PL Proposal, the Commission has chosen to ignore Congress's intent regarding the definition of bona fide hedging, which was to preserve the use of derivatives for end-users to hedge price risks that arise in the normal course of business. Instead, the Commission has narrowed the definition, which would make hedging more difficult for end-users.[13] Further, the PL Proposal's elimination of CFTC regulation

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[12] 17 C.F.R. § 1.3(z).

[13] *See* e.g., House Passes Peterson-Frank Amendment to Strengthen Regulation of Over-the-Counter Derivatives, Dec. 10, 2009, *available at* http://democrats.agriculture.house.gov/press/PRArticle.aspx?NewsID=207 (amendments that introduce Congress's definition of "bona fide hedging" transactions at CEA Section 4a(c)(2) described as "preserving the use of derivatives for end-users to hedge price risks associated with their businesses.").

1.47[14] would make it more difficult for market participants to receive clarification regarding which non-enumerated, risk-reducing practices may qualify for the bona fide hedge exemption, as the industry would no longer have certainty of the timeframe in which the Commission would provide its response.[15] In addition, the PL Proposal's interpretation of the statutory "economically equivalent" requirement for a bona fide hedge does not appear to comport with commercial market practices, such as portfolio risk management, which has been recognized by the Commission since the 1970s.[16] Accordingly, the bona fide hedging definition in the PL Proposal is too narrow, does not reflect the realities of commercial end-users hedging needs, and is contrary to Congress's intent.

Greater-than-Fifty Exemption

We appreciate and support the Commission's decision to include, in the Aggregation Proposal, an exemption to permit, in appropriate circumstances, disaggregation notwithstanding an investment by an "owner entity" that exceeds 50 percent, and up to 100 percent, of the ownership interest in an "owned entity" (the "Greater-than-Fifty Exemption"). However, as an initial matter, we question the statutory and logical validity of an exemption from a standard that is not authorized by CEA Section 4a and which was enunciated by the Commission for the first time in 2011 despite being characterized as a long-standing Commission requirement. CEA Section 4a(a)(1) requires aggregation based on the ownership of positions in accounts or on the ability to exercise trading control. Administrative agencies, such as the Commission, cannot implement a statutory provision, such as CEA Section 4a(a)(1), by prohibiting what its terms explicitly permit. The owned entity "exemptions," are in fact aggregation standards. As drafted in the Aggregation Proposal, they would require aggregation where an entity can irrefutably prove that: (1) it does not hold any coherent semblance of an ownership or financial interest in derivatives positions (let alone a 10 percent ownership or financial interest); or (2) have any ability to influence the corporate

[14]*See* 17 C.F.R. § 1.47(a) (provides that market participants may request a determination from the Commission on the applicability of the bona fide hedging exemption to non-enumerated risk-reducing practices commonly used in the market, and that the Commission will have 30 days to respond (or 10 days to respond for an amendment to an existing request)).
[15]The Commission noted in the PL Proposal that it "preliminarily believes it should not constrain itself to such limited timeframes for review of potentially complex and novel risk-reducing transactions." PL Proposal, 78 Fed. Reg. at 75,739.
[16]*See* PL Proposal, 78 Fed. Reg. at 75,708; 7 U.S.C. §§ 6a(a)(5), 6a(c)(2).

decisions of another legal entity (let alone exercise trading control). We urge the Commission to acknowledge and address this fundamental contradiction.

Assuming that the Commission chooses to adopt an owned entity standard for aggregating positions, and if such a standard is permitted to become effective, we also question the procedural requirements of the Greater-than-Fifty Exemption which render it unusable. Under the Aggregation Proposal, an "owner entity" would first be required to submit an application to the CFTC and wait for the Commission's approval prior to the effectiveness of the Greater-than-Fifty Exemption. CCMC believes that such a requirement would make this exemption unworkable in practice as the application and approval process would consume significant CFTC staff resources and would not provide any apparent regulatory benefits, and the review process would create unreasonable delays and uncertainty for market participants awaiting a Commission decision on the Greater-than-Fifty Exemption. Moreover, the delay does not appear justified as the Commission has not demonstrated or identified any risk of abuse of this proposed exemption.

CCMC instead believes that the Commission should permit an owner entity to claim the Greater-than-Fifty Exemption via a notice filing in which the owner entity has certified and demonstrated that it meets each of the requirements and conditions of the proposed exemption. The exemption should become effective upon submission of the filing to the Commission. A notice filing process, subject to requiring ongoing compliance with the remaining conditions of the Greater-than-Fifty Exemption, would address the Commission's concerns by ensuring that "[an owner entity] and the owned entity have procedures in place that are reasonably effective to prevent coordinated trading[, and] [t]he [owner entity can] demonstrate that it does not control the owned entity's trading even though the [owner entity] is the majority owner of the owned entity."[17]

Conclusion

We believe that the Commission's failure to consider current, accurate data in issuing the PL Proposal, and the PL Proposal in its current form, would lead to

[17] Aggregation Proposal, 78 Fed. Reg. at 68.959.

decreased liquidity that is essential to enable market participants to hedge and operate their businesses in an efficient and effective manner. Further, we believe the PL Proposal would impair the efficiency and effectiveness of the U.S. derivatives markets through increased costs to hedgers, which likely would be passed on to consumers. The Commission has acknowledged the inaccuracy and insufficiency of its data, as well as the inconclusive nature of existing studies and other empirical evidence regarding position limits. Thus, CCMC believes that the Commission should delay rulemaking on position limits until it ensures that it has accurate and usable swap data. Only then can the Commission engage in a full and fair examination of the facts and come to a clear understanding of the issues and unintended consequences from the implementation of position limits in the markets as they exist today. In addition, the narrowing of the bona fide hedging exemption in the PL Proposal would make it more difficult for commercial end-users to hedge, while the approval process to use the Greater-than-Fifty Exemption set forth in the Aggregation Proposal is unnecessarily costly and time consuming.

The CCMC welcomes the opportunity to work with the Commission to achieve a fair and rational implementation of the Dodd-Frank Act's position limit provisions.

Sincerely,

David Hirschmann