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January 22, 2015

VIA ON-LINE SUBMISSION

Mr. Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

**Re: Re-Opening of Comment Period for Position Limits for Derivatives (RIN 3038-AD99) and
Aggregation of Positions (RIN 3038-AD82)**

Dear Mr. Kirkpatrick:

CME Group Inc. ("CME Group")¹ respectfully submits this letter in response to the Commodity Futures Trading Commission's ("Commission" or "CFTC") re-opening of the comment period² for the Notice of Proposed Rulemakings regarding "Position Limits for Derivatives" ("Position Limits Proposal")³ and "Aggregation of Positions" ("Aggregation Proposal")⁴ (collectively, the "Proposal"). CME Group appreciates the Commission's efforts to continue to consider the significant practical consequences the Proposal would have on derivatives markets and commercial end-users in particular. CME Group

¹ CME Group is the holding company for four separate U.S. 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 and Aggregation of Positions, 79 Fed. Reg. 71973 (Dec. 4, 2014); see also Position Limits for Derivatives and Aggregation of Positions, 80 Fed. Reg. 200 (Jan. 5, 2015).

³ Position Limits for Derivatives, 78 Fed. Reg. 75680 (Dec. 12, 2013).

⁴ Aggregation of Positions, 78 Fed. Reg. 68946 (Nov. 15, 2013).

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requests that the Commission consider the contents of this letter alongside CME Group's prior comment letters submitted in connection with the Proposal.⁵

Specifically, the Commission has requested further comments related to the following two issues discussed at the Commission's December 9, 2014 meeting of the Agricultural Advisory Committee ("AAC Meeting"): (1) the scope of the bona fide hedging position definition for agricultural commodity derivatives and (2) the process to be used for estimating deliverable supplies of agricultural commodities in order to set spot month limits. In responding to these issues, CME Group's comments are not limited to only agricultural commodities as the two issues highlighted by the Commission are relevant to market participants in *all* physical commodity derivative markets that would be impacted under the Proposal. CME Group respectfully requests that in reconsidering the Proposal's treatment of bona fide hedge exemptions and deliverable supply estimates, the Commission adopt a more holistic approach that is informed by the recommendations in this and CME Group's prior comment letters.

I. BONA FIDE HEDGING POSITIONS

A. *The Bona Fide Hedging Position Definition Must Accommodate All Reasonable Commercial Hedging Strategies*

CME Group feels strongly that the Commission must allow commercial market participants to continue their traditional hedging operations uninterrupted. Unfortunately, the current Proposal limits the bona fide hedging position definition in the face of both historical precedent and Congressional intent. As CME Group and numerous other market participants have previously commented, neither the legislative history of Dodd-Frank nor the plain language of the Commodity Exchange Act ("CEA") itself supports a narrowing of the bona fide hedging position definition. In fact, this aspect of the Proposal is directly at odds with the CEA's stated purpose of promoting "sound risk management" and Congress' clear intent that CEA section 4a(c)(2) was intended to *preserve* a hedger's pre-Dodd Frank risk management tools.⁶ The Commission should reject the Proposal's attempt to narrow the bona fide hedging position definition for the myriad reasons articulated in CME Group's prior comment letters.⁷

The core flaw in the Proposal's definition is the restricting of bona fide hedges for physical commodity derivatives to a defined list of enumerated transactions. Rather than allow market

⁵ See Letter from CME Group to CFTC re Position Limits for Derivatives (RIN 3038-AD99), dated February 10, 2014 ("Position Limits Letter"); Letter from CME Group to CFTC re Aggregation of Positions (RIN 3038-AD82), dated February 10, 2014 ("Aggregation Letter"); Letter from CME Group to CFTC re Position Limits for Derivatives (RIN 3038-AD99) in response to CFTC public roundtable, dated August 4, 2014 ("Hedging and Aggregation Letter"); Letter from CME Group to CFTC re Position Limits for Derivatives (RIN 3038-AD99) in response to CFTC public roundtable, dated August 4, 2014 ("Five Times Limits Letter").

⁶ See, e.g., Floor Statement by the Hon. Frank D. Lucas, Ranking Member, House Com. On Ag., Re: H.R. 4173, the Wall Street Reform and Consumer Protection Act (Dec. 10, 2009) ("[W]e were able to improve areas most important to end-users – the manufacturers, the energy companies and food processors that use swap agreements to manage price risk so they can provide consumers the lowest cost products"); Letter from Sen. Christopher Dodd and Sen. Blanche Lincoln to Rep. Barney Frank and Rep. Colin Peterson (June 30, 2010) (cautioning the Commission to "not make hedging so costly it becomes prohibitively expensive for end users to manage risk").

⁷ See Position Limits Letter, *supra* note 5, at 45-69.

participants to engage in any *reasonable* commercial risk reduction practice that satisfies the three statutory criteria, the Commission has artificially defined the universe of what those practices can encompass. CME Group supports a bona fide hedging position definition that accommodates all reasonable commercial risk reduction strategies, including (but not limited to) those customary commercial practices detailed in the Petition submitted to the Commission by the Working Group of Commercial Energy Firms.⁸ By adopting a more flexible approach that recognizes traditional hedging practices, the Commission will avoid becoming inundated with requests to approve additional exemptions that needlessly tie up limited Commission resources. Simply put, there is no justification for narrowing the statutory definition of bona fide hedging positions in such a way that does not recognize these customary commercial practices.

CME Group is mindful of the Commission's concern over the potential for abuse of bona fide hedge exemptions under an expanded position limits regime. However, the Proposal's restrictions are based on a fundamental and unfounded perception that excessive speculation is, as a matter of course, routinely disguised as bona fide hedging. If pervasive evasion is a concern, the Commission should rely upon its existing anti-evasion authority to investigate practices that the Commission perceives to be incompatible with the purposes of bona fide risk reduction. Through monitoring position and other supporting reports (*e.g.*, Form 204), the Commission could issue special calls to further investigate a trader's hedging practices and determine whether the trader's true intent in amassing a certain position was risk reduction or speculation. Given the cornerstone role physical commodity derivatives have played for decades in managing the risks of commercial end-users, CME Group respectfully requests the Commission reconsider the Proposal's definition of a bona fide hedging position and abandon the proposed overly restrictive approach in favor of a more flexible regime.

B. The Bona Fide Hedging Position Definition Must Be Harmonized with European Proposals In Order to Avoid Regulatory Arbitrage

European regulators have proposed to exempt risk reducing trades from position limits under MiFID II and have proposed linking the definition of a risk reducing trade to the broad hedging definition provided under EMIR. CME Group believes this broader European hedging definition would allow for the very types of customary risk reducing transactions that the Commission has explicitly refused to recognize under the Proposal—*e.g.*, anticipatory hedging. If both the Commission and European regulators continue down their current paths, CME Group is fearful that significant liquidity from the US will migrate to Europe where commercial end-users would be able to manage risks free from the increased costs and burdens that the Proposal would impose on hedging practices.

Currently, European regulators are in the process of considering public comments and just beginning to finalize rules concerning a new position limits regime that will not become effective until January 2017. Meanwhile, US markets already are subject to existing federal and exchange-imposed position limits. CME Group therefore sees no reason for the Commission to rush to finalize a new position limits regime that has the potential to create opportunity for liquidity-killing regulatory arbitrage while cross-border market participants are just beginning to weigh one proposed regime

⁸ See Petition from the Working Group of Commercial Energy Firms, to the commission (Jan. 20, 2012).

against another. Recognizing the increasingly global interconnectedness of derivatives markets, CME Group respectfully requests that the Commission lead the process to make sure that its rules are effectively harmonized with other international regimes. Position limits offer a prime area in which the Commission can demonstrate this leadership in order to achieve a harmonized policy—accommodating at least traditional bona fide hedging techniques—that will benefit market participants in both the US and abroad.

II. DELIVERABLE SUPPLY ESTIMATES

A. *Deliverable Supply Estimates Should be Based on Current Data Supplied by Exchanges*

As CME Group has argued in previous letters, any expansion of spot month limits to cover the 28 core referenced futures contracts and economically equivalent swaps must be based on current and accurate deliverable supply estimates provided by exchanges. Yet the Proposal currently sets initial spot month limits based on stale data, meaning the Commission is proposing to make a critical regulatory decision without a reliable, accurate baseline to determine the appropriate spot month limits. CME Group appreciates the Commission's willingness to consider updated data from the exchanges and has submitted its most current deliverable supply estimates for certain physical commodities. CME Group further appreciates the Commission's interest in receiving such data from those exchanges that list physical delivery benchmark contracts and believes the Commission should give considerable weight to those estimates.

CME Group also requests that before finalizing spot month limits based on any updated deliverable supply estimates from exchanges, the Commission should provide the public with an opportunity to comment. It is important that market participants understand why the Commission either does or does not believe these most recent deliverable supply estimates are a reasonable basis for setting spot month limits. If the Commission does not set initial spot month limits based on these updated estimates, CME Group respectfully requests that the Commission should explain, and seek public comments on, its rationale for using whatever alternative source of data is employed.

B. *Spot Month Limits Should Not Exceed 25% of Deliverable Supply and Should be the Same for Physical Delivery and Cash-Settled Contracts*

The Commission has proposed using a blanket 25% of deliverable supply formula for purposes of setting initial spot month limits. CME Group respectfully requests that the Commission emphasize that 25% of deliverable supply is the ceiling for setting spot month limits for any particular physical commodity. The updated deliverable supply estimates submitted to the Commission by CME Group generally reflect an increase in deliverable supply and would therefore indicate that some increase in spot month limits would be appropriate. CME Group does not believe, however, that pursuing a one-size-fits-all approach of a 25% of estimated deliverable supply across all commodities is supported by any sound economic theory or analysis. In fact, such an approach is in direct contradiction to the Commission's previous position that speculative position limits should "be based upon the individual characteristics of a specific contract market."⁹ To achieve that result, CME Group believes the

⁹ See Revision of Federal Speculative Position Limits, 52 Fed. Reg. 6812, 6815 (proposed March 5, 1987).

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Commission should work with those exchanges listing benchmark physical delivery contracts to set appropriate federal limits below the 25% ceiling.

While each physical commodity should be treated differently in setting spot month limits, CME Group respectfully requests that all contracts based on the same underlying physical commodity, whether physically delivered or cash-settled, be subject to identical spot month limits. First, across all contracts based on the same underlying legacy agricultural commodity, parity should exist for purposes of calculating position limits. For example, legacy wheat contracts listed by various exchanges should not be subject to different non-spot month limits as proposed that in some cases would be significantly lower than current levels. Such a result would mean reduced liquidity for spread transactions between the various grades of wheat underlying each contract and therefore directly contradict CEA section 4a(a)(3)(B) safeguards requiring the Commission to ensure that sufficient liquidity for bona fide hedgers exists and the price discovery function of the underlying market is not disrupted.

Additionally, parity in establishing limits should exist between physical delivery and cash-settled contracts. As discussed in CME Group's Five Times Limits Letter,¹⁰ the consequences of the Proposal's conditional spot-month limit for cash-settled contracts would be to drain liquidity from the physical delivery market into the cash-settled market during the spot month as contracts approach delivery. Such a result also would be at odds with European regulators' proposal to establish equal limits for physical delivery and cash-settled contracts under MiFID II. CME Group understands that most commercial end-users in agricultural commodity markets currently utilize physical delivery contracts to accomplish their hedging purposes. The Commission should consider whether these agricultural end-users would be comfortable having to chase after liquidity provided by speculators as it flows into cash-settled markets and the potential deleterious effects on settlement prices that would result from less liquid markets for the physical delivery contracts upon which the cash-settled contracts are priced.

C. *Accountability Levels Should Apply in Lieu of Hard Limits Outside of the Spot Month for Non-Legacy Agricultural Commodity Derivatives*

The Commission has interpreted CEA section 4a(a)(1) as providing authority to impose position limits in order to curb excessive speculation and made a necessity finding in the Position Limits Proposal to justify imposing hard limits for physical commodity derivatives in both spot and non-spot months.¹¹ However, this necessity finding is arbitrarily based on the assumption that hard limits in both the spot and non-spot months are the only tools that could have effectively prevented the silver and natural gas manipulation episodes cited by the Commission. The Position Limits Proposal is silent on whether accountability levels in the out months could have been equally effective. Should the Commission believe it is required to impose some sort of limits outside of the spot month, CEA section 4a(a)(3) supports having the Commission adopt accountability levels as an "appropriate" alternative to hard limits.

¹⁰ See *supra* note 5.

¹¹ Position Limits Proposal, 78 Fed. Reg. at 75,685-96.

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CME Group believes market integrity outside of the spot month for non-legacy agricultural contracts (including for purposes of all-months combined limits) would be better served if the Commission expanded upon the existing regime of exchange-imposed and administered position accountability levels. Effective price discovery relies upon liquid physical commodity derivative markets in the out months. Recognizing the potential negative impact on liquidity that rigid limits can have, the Commission currently allows exchanges to impose flexible accountability levels outside of the spot month for certain physical commodity derivative contracts.¹² CME Group respectfully requests that the Commission mandate accountability levels in non-spot months as the rule, not the exception, in order to better protect liquidity and price discovery in the non-legacy agricultural markets that are being folded under the Commission's position limits regime for the first time.¹³ CME Group believes the Commission can capitalize on exchanges' existing infrastructure and experience enforcing accountability levels to prevent an additional drain on the Commission's limited resources.

Under an accountability regime, a trader may be required to do one of several things if an accountability level is exceeded after the exchange investigates further and can make a determination as to what would be most appropriate in the context of safeguarding against market congestion and abusive trading practices: freeze the position, draw down the position, or take no action. Exchanges, however, do not have access to a trader's aggregate position data, including any uncleared OTC positions that the trader may hold. To accommodate the expansion of position limits under the Proposal to cover economically-equivalent swaps (both cleared and uncleared) in addition to core referenced futures contracts, CME Group recommends the Commission bifurcate primary responsibility as follows for purposes of overseeing covered positions outside of the spot month under accountability levels:

- *Cleared positions.* An exchange establishes and monitors accountability levels for combined positions in cleared, core referenced futures contracts and economically-equivalent swaps held on the exchange. The exchange bears primary responsibility for monitoring these positions and, if the relevant accountability level is exceeded, investigating and determining whether to order the trader to freeze or reduce a position's size, or to take no action.
- *Uncleared OTC positions.* The Commission establishes and monitors accountability levels for uncleared OTC positions. The Commission monitors these positions, bearing sole responsibility for interfacing directly with a trader who holds uncleared positions in excess of the accountability level that the Commission determines merits further review and

¹² As CME Group has previously argued to the Commission in 1993, the negative effect of non-spot month hard cap limits on liquidity and price discovery in markets for non-storable agricultural commodities such as livestock and dairy can be even more pronounced. See CME Submission No. 93-25, Proposed Amendments to the Speculative Position Limit Provisions of the Chicago Mercantile Exchange's Live Cattle, Feeder Cattle, Live Hogs, and Pork Bellies Futures and Option Contracts. The Commission responded by recognizing this market fundamental and allowing CME to abandon an all-months-combined limit for continuously-produced and non-storable commodities.

¹³ CME Group believes that after the Commission has been able to observe for a period of time the effects of non-spot month accountability levels for non-legacy agricultural derivatives as proposed herein, the Commission, in consultation with the exchanges, can determine whether it would be appropriate and desirable to expand the accountability regime to cover legacy agricultural contracts.

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determining whether to order the trader to freeze or reduce a position's size, or to take no action.

- *Aggregate Cleared & Uncleared OTC positions.* The Commission establishes and monitors aggregate accountability levels for combined cleared and OTC uncleared positions that are generally higher than the exchange-set levels for cleared positions alone. The Commission monitors these aggregate positions, bearing primary responsibility for interfacing directly with a trader who holds a majority uncleared position in excess of the aggregate accountability level and determining whether to order the trader to freeze or reduce a position's size, or to take no action. Where the majority of the trader's position is cleared, the Commission would notify the relevant exchange(s) who will coordinate amongst themselves (and with the Commission, if necessary) to determine whether to order the trader to freeze or reduce a position's size, or to take no action.

CME Group supports the CFTC retaining authority to take any appropriate action it deems necessary with respect to a cleared position where, pursuant to a majority vote of the Commission, an exchange is found to have been uncooperative or unresponsive to Commission notification of an aggregate accountability level breach.

CME Group believes that the accountability structure summarized above achieves the Commission's intended goals of establishing a reasoned position limits regime, while leveraging exchange resources already established and available to support such a structure without draining the Commission's limited resources.

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CME Group thanks the Commission for the opportunity to further comment on the 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@cmegroup.com; Thomas LaSala, Managing Director, Chief Regulatory Officer by telephone at 212-299-2897 or by e-mail 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.

Sincerely,



Kathleen Cronin
Senior Managing Director,
General Counsel and Corporate Secretary