asset management group

November 13, 2015

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

Re: Supplemental Notice of Proposed Rulemaking – Aggregation of Positions (RIN 3038-AD82)

The Asset Management Group ("AMG")[1] of the Securities Industry and Financial Markets Association ("SIFMA") appreciates the opportunity to provide the Commodity Futures Trading Commission ("Commission") with comments regarding the Commission's Supplemental Notice of Proposed Rulemaking on "Aggregation of Positions" ("Supplemental Aggregation NPRM").[2]

AMG members have a significant interest in the Commission's aggregation requirements for speculative position limits due to the impact these requirements can have on both asset managers' and their clients' ability to operationalize compliance with position limits and the related burdens that can diminish investors' returns. To date, we have actively participated in the Commission's public processes regarding its position aggregation proposal (the "Proposal"), including by: 1) submitting a comment letter on the initial proposed rulemaking on aggregation ("Initial Aggregation NPRM");[3] 2) serving on the Aggregation Panel at the staff's public Roundtable on position limits held on June 19, 2014; and 3) submitting a second comment letter to respond in greater detail to questions that were asked of the Aggregation Panel during the Roundtable.[4] AMG submits this letter to provide further comment on the impact of the proposed aggregation requirements, as modified by the Supplemental Aggregation NPRM, on asset managers and their clients.

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[1] AMG's members represent U.S. asset management firms whose combined assets under management exceed $30 trillion. The clients of AMG member firms include, among others, registered investment companies, endowments, state and local government pension funds, private sector Employee Retirement Income Security Act of 1974 pension funds, undertakings for collective investments in transferable securities ("UCITS") and private funds such as hedge funds and private equity funds.

[2] *Aggregation of Positions,* 80 Fed. Reg. 58,365 (Sept. 29, 2015).

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

[4] A copy of AMG's first comment letter on the Initial Aggregation NPRM, filed on February 10, 2014 ("First AMG Aggregation Letter"), and its second comment letter after the staff Roundtable, filed on August 1, 2014 ("Second AMG Aggregation Letter"), are enclosed for convenience.

AMG commends the Commission for proposing in the Supplemental Aggregation NPRM the positive step of applying the same requirements for disaggregating positions of an owned entity regardless of whether the ownership interest is more or less than 50%. We appreciate the Commission's receptivity to comments voiced by AMG and others that the originally proposed disaggregation requirements for ownership interests greater than 50% were unworkable and ill-advised.

Nevertheless, AMG continues to have concerns about the Commission's proposed position aggregation requirements as applied to passive investors. In particular, we believe that: 1) the Commission should harmonize its aggregation requirements for passive investors across the various types of entities in which they invest; 2) the Commission should not adopt the "owned entity aggregation requirement" as currently proposed in the Supplemental Aggregation NPRM;[5] 3) if the Commission does adopt the proposed owned entity aggregation requirement, it also should revise and clarify certain aspects of the exemption that, if satisfied, permits disaggregation of an owned entity's positions; and 4) the Commission should consider other of its aggregation exemptions that raise similar concerns as the owned entity exemption.

AMG's recommended changes to the aggregation requirements are needed to avoid negative operational consequences and costs that would ultimately be detrimental to asset managers' clients. As discussed further below, these burdens imposed upon *passive investors* would not advance the Commission's purpose of imposing position limits—namely, to help prevent *coordinated trading* that could yield excessive speculation and unwarranted price changes.

I. The Commission Should Harmonize its Position Aggregation Requirements as Applied to Passive Investments Across Entity Types

As we have explained in our First and Second AMG Aggregation Letters, it is critical to remember that, in terms of equity interests in other entities, AMG's members manage the funds of *passive* investors. AMG's members act in a fiduciary capacity for investment vehicles in which these passive investors have interests, including, without limitation, registered and private commodity pools and other investment vehicles, pension funds and other institutional clients of asset managers. The entities in which these passive investors may have an ownership interest include: 1) entities other than commodity pools, such as operating companies (hereafter referred to as "owned entities"); 2) non-exempt commodity pools; and 3) a subset of commodity pools

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[5] In the First and Second AMG Aggregation Letters, AMG urged the Commission, among other things, to extend the owned entity exemption of proposed rule 150.4(b)(2) to include ownership interests greater than 50% that do not involve actual common trading control, and we welcome the Commission's decision to make that proposal in the Supplemental Aggregation NPRM. *See* 80 Fed. Reg. at 58,369 and n.42. However, the prior AMG Aggregation Letters objected to the proposed owned entity aggregation requirement for passive investors in the first instance, and discussed several other issues and made several other recommendations that were not addressed in the Supplemental Aggregation NPRM. These issues and recommendations are the primary focus of this letter.

that are operated by commodity pool operators ("CPOs") that are exempt from registration with the Commission under Rule 4.13 ("Rule 4.13 exempt pools").

In each instance, these passive investors have no control over, nor any real-time knowledge of, the specific commodity derivatives trading activities of the entities in which they have invested. And yet, as currently structured in light of the Supplemental Aggregation NPRM, these passive investors: 1) under proposed rule 150.4(b)(2), must aggregate positions of owned entities when their ownership interest meets or exceeds 10%, unless they submit a filing and certification of trading independence under the owned entity exemption; 2) under proposed rule 150.4(b)(1), if they are unaffiliated with the CPO, need not aggregate positions of non-exempt commodity pools under any circumstances;[6] and 3) under proposed rule 150.4(b)(1)(iii), must aggregate positions of a Rule 4.13 exempt pool when their ownership interest meets or exceeds 25% without exception.

Requiring passive investors to aggregate the positions of owned entities at a 10% or greater ownership interest, or the positions of Rule 4.13 exempt pools at a 25% or greater ownership interest, imposes significant costs. These costs inherently and unnecessarily diminish their ability to provide valuable capital investment and generate returns for their beneficiaries and participants.

Accordingly, as we have previously commented, passive investors should not be subject to such starkly different position aggregation requirements depending on the type of entity in which they invest. Passive investors in owned entities and passive investors in Rule 4.13 exempt pools should be treated the same as unaffiliated passive investors in non-exempt pools – namely, they should not be required to aggregate, and they should not have to make a filing with the Commission as a condition of such disaggregation.

As discussed in our First AMG Aggregation Letter, such harmonization of aggregation requirements can be achieved by:

Excluding from Aggregation Requirements Passive Investors in Owned Entities, Similar to the Commission's Exclusion for Unaffiliated Passive Investors in Non-Exempt Pools. Under proposed rule 150.4(b)(1), which mirrors current rule 150.4(c), unaffiliated limited partners, shareholders and other similar types of participants in non-exempt pools (as well as limited members under the proposed rule) need not aggregate the pool's positions with their own positions, and are not required to make any filing with the Commission in order to rely on this disaggregation exemption. We do not believe there is a meaningful difference between unaffiliated passive investors in non-exempt pools and passive investors in owned entities in terms of whether a filing should be required to establish that these investors have no ability to influence trading decisions. Therefore, passive investors in owned entities should be treated the same as unaffiliated passive non-exempt pool participants by permitting them to disaggregate the

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[6] Similar to owned entities, under proposed rules 150.4(1)(i) and (ii), a 10% or greater owner in a non-exempt commodity pool must aggregate the positions of the pool if it is the CPO, or if it is a principal or affiliate of the CPO unless it submits a filing and certification of trading independence.

positions of those owned entities without requiring a filing with the Commission in order to do so.[7]

Likewise, Excluding from Aggregation Requirements Passive Investors in Rule 4.13 Exempt Pools. The Commission should revise proposed rule 150.4(b)(1)(iii), which is identical to current rule 150.4(c)(3), to require passive investors to aggregate positions of a Rule 4.13 exempt pool based on a 25% or more ownership interest only when "the operator of [the pool] is exempt from registration *under §§ 4.13(a)(1) or (a)(2).*" The rationale for the current rule was that when there are "10 or fewer limited partners or when a limited partner has an ownership interest of 25% or greater, the limited partner" should be required to aggregate the positions of the pool.[8] The Commission was particularly concerned about single-investor pools when it adopted this requirement.[9] The only sub-paragraphs of current rule 4.13 that encompass the intended targets of this provision are sub-paragraphs (a)(1) and (a)(2). Further, exempt pools under sub-paragraph (a)(3) of rule 4.13, by definition, have only a de minimis amount of swaps and futures activity, which makes it counter-intuitive that passive investors in such pools be subjected to the strictest aggregation requirement. Accordingly, we recommend that the Commission revise proposed rule 150.4(b)(1)(iii) to apply to pools "the operator of which is exempt from registration *under §§ 4.13(a)(1) or (a)(2)*" in order for this requirement to apply to its intended targets.[10]

II. The Commission Should Not Require Passive Investors of Owned Entities to Aggregate Positions When They Do Not Have Actual Control Over the Owned Entities' Trading

As discussed above, passive investors in owned entities should be permitted to disaggregate the positions of those owned entities without requiring a filing with the Commission in order to do so. As discussed below, the Commission has recognized in the Supplemental Aggregation NPRM that aggregation should be required based solely on actual

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[7] First AMG Aggregation Letter at 4-6.

[8] *Revision of Federal Speculative Position Limits and Associated Rules,* 64 Fed. Reg. 24,038, 24,044 (May 5, 1999).

[9] *Id.*

[10] First AMG Aggregation Letter at 13.

In our First AMG Aggregation Letter, we also recommended that the Commission: 1) not adopt the requirement in proposed rule 150.4(a)(2) to aggregate investments in funds that follow "substantially identical trading strategies" regardless of common trading control, significant ownership, or even knowledge of the relevant investments on the basis that this proposal is vague and unworkable in practice, and lacks sufficient statutory, policy, and cost-benefit rationale (First AMG Aggregation Letter at 13-14); and 2) extend "independent account controller" eligibility to registered CPOs, exempt CPOs, and exempt and excluded commodity trading advisors (First AMG Aggregation Letter at 15). We renew these recommendations here.

control over trading, and passive investors simply have no such control. Imposing an aggregation requirement on passive investors in owned entities creates practical issues that render compliance overly burdensome, if not impossible, and is unwarranted to achieve the objectives that the Commission's aggregation rules are designed to achieve.

A. The Proposal Improperly Equates Ownership with Control, Creating Practical Issues that Render Compliance by Passive Investors Overly Burdensome, If Not Impossible

We commend the Commission for acknowledging in the Supplemental Aggregation NPRM that, as AMG has argued, aggregation of another entity's derivatives positions should be based on control over the trading of those positions:

> The Commission believes that, on balance, the overall purpose of the position limits regime (to diminish the burden of excessive speculation which may cause unwarranted changes in commodity prices) would be better served by focusing the aggregation requirement on situations where the owner is, in view of the circumstances, actually able to control the trading of the owned entity. The Commission reasons that the ability to cause unwarranted changes in the price of a commodity derivatives contract would result from the owner's control of the owned entity's trading activity.[11]

Notwithstanding this acknowledgement, however, the Supplemental Aggregation NPRM does not propose to limit the aggregation requirement with respect to owned entities to "situations where the owner is, in view of the circumstances, actually able to control the trading of the owned entity." Rather, it proposes to presume control and therefore require a person to aggregate an owned entity's positions based solely on the fact of ownership (at or above 10%) – and then to place the burden on the person to establish that there is no actual control over trading through a filing with the Commission that includes a certification that all five conditions of disaggregation set out in proposed rule 150.4(b)(2)[12] have been met:

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[11] 80 Fed. Reg. at 58,371 (footnote omitted).

[12] Under proposed rule 150.4(b)(2), the owned entity exemption must be established by a filing that includes a description of the relevant circumstances that warrant disaggregation, and a certification by a senior officer that the five conditions of the owned entity exemption have been met. Those conditions are that the owner and the owned entity: 1) do not have knowledge of the trading decisions of the other; 2) trade pursuant to separately developed and independent trading systems; 3) have and enforce written procedures to preclude each from having knowledge of, gaining access to, or receiving data about, trades of the other (which procedures must include document routing and other procedures or security arrangements, including separate physical locations, which would maintain the independence of their activities); 4) do not share employees that control the trading decisions of either; and 5) do not have risk management systems that permit the sharing of trades or trading strategy. We note that a certification that these conditions have been met can be based only on the knowledge of the entity making the certification; to demand otherwise would require owners to perform due diligence on their owned entities in order to make these filings, an onerous burden that, in some circumstances, may not be possible.

> [A]ggregation would still be the "default requirement" for the owner of a 10 percent or greater interest in an owned entity, unless the conditions of proposed rule § 150.4(b)(2) are satisfied.[13]

Adopting an "aggregate unless you establish no control" approach rather than an "aggregate if you control" approach is not a distinction without a difference to AMG members. While asset managers generally would not need to aggregate customer positions managed by independent account controllers under the independent account controller ("IAC") exemption in proposed rule 150.4(b)(5), individual IAC or non-IAC asset managers often invest customer assets (either directly or through investment vehicles) in entities that trade in commodity derivatives through passive equity interests in such entities. These asset managers would be impacted, substantially and adversely, by the requirement in the Commission's proposed rule 150.4(a) that a purely passive holder of equity securities must aggregate the positions of all owned entities of which it has beneficial equity ownership of 10% or more, unless it perfects an exemption to owned entity aggregation under proposed rule 150.4(b)(2).[14]

The Commission's owned entity aggregation requirement would create a new standard of care for passive investors in owned entities: they would have to determine whether and to what extent the 10% or greater owned entity (and all of its 10% or greater owned entity affiliates) trade in commodity derivatives and if so, act to perfect an exemption. This may not even be possible for many passive investors in various circumstances because an investor may not have access to this type of detailed information about a company in which it intends to invest. For example, if a person invests in a company but does not have the right to prevent the concentration or magnification of its investment over time due to redemptions or losses, the investor's ownership interest percentage in the company (and whether it meets the 10% threshold) could change on a real-time basis without the investor's knowledge. Investors should not be held to compliance obligations that are, as a practical matter, beyond their control to fulfill.

If no exemption is available, or the owner cannot or does not receive sufficient information from the owned entity to be able to conclude that the owned entity has taken steps to formally satisfy the requirement, then the passive investor would have to obtain reliable commodity derivatives position information from the entities in which it invests, which also would have to be updated on a real-time basis, in order to ensure compliance with speculative position limits. Even if companies were willing to provide accurate and timely information upon request from investors, these passive investors would have to develop, often from scratch, costly position monitoring infrastructure and hire or train staff to apply that infrastructure to the derivatives positions of their investments in order to ensure compliance with position limits. The costs to passive investors associated with these requirements would therefore deter investment in

[13] 80 Fed. Reg. at 58,371 (footnote omitted).

[14] Practical compliance issues similar to those discussed in this Section with respect to the Proposal's owned entity aggregation requirement confront fund investors as well. These compliance issues are discussed in Section III below.

businesses that own commodity positions, and are not offset by any commensurate benefit, especially in terms of reduced likelihood of excessive speculation.

These costs to investors are significant, yet the Proposal does not take such costs into account in its cost-benefit analysis.

B. The Proposal's Presumption that Ownership Equates with Control is Unwarranted as Applied to Passive Investors

As noted above, the Commission has recognized in the Supplemental Aggregation NPRM that the purpose of the aggregation rules is to help prevent coordinated trading that could yield the type of excessive speculation and unwarranted price changes that the speculative position limits rules are designed to address. Passive investors, regardless of the percentage of their ownership interest, do not have control over the trading decisions of such owned entities that would raise the specter of coordinated trading activity for position limits purposes.[15] Therefore, for purposes of the Commission's aggregation rules for position limits (*i.e.,* preventing coordinated trading activity that can lead to excessive speculation and unwarranted price moves), a passive ownership interest in a legal entity is not a sufficient basis for the Commission to impose an owned entity aggregation requirement.[16]

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[15] Under some circumstances, when a passive investor (for example, an ERISA plan) makes an investment in an entity, the investor's fiduciary duties (for example, as created under ERISA) could entail making prudent inquiries into the trading activities and investments of the owned entity. *See Harley v. Minnesota, Mining and Manufacturing Co*., 898 F. Supp. 2d 898, 906 (D. Minn. 1999) ('[A] fiduciary is required to undertake an independent investigation into the merits of an investment and to use appropriate, prudent methods in conducting the investigation."), *aff'd,* 284 F.3d 901 (8th Cir. 2002), *cert. denied,* 537 U.S. 1106 (2003); 29 CFR 2550.404a-1(b)(2) (providing that an investment fiduciary, when evaluating an investment, must take into consideration the risk of loss associated with the investment). This fiduciary duty to prudently inquire falls far short of an opportunity for coordinated trading. The Initial Aggregation NPRM recognized this, stating that the Proposal "would generally not require aggregation solely based on knowledge that a party gains . . . when carrying out due diligence under a fiduciary duty, so long as such knowledge is not directly used to affect the entity's trading." 78 Fed, Reg. at 68,961.

[16] According to the Supplemental Aggregation NPRM, the view that "ownership of an entity is an appropriate criterion for aggregation of that entity's positions" is "supported by Congressional direction and Commission precedent from as early as 1957 and continued through 1999." 80 Fed. Reg. at 58,372 (footnote omitted). For the reasons set out in both the First and Second AMG Aggregation Letters, we continue to believe the Commission's proposed owned entity aggregation requirement exceeds the Commission's authority under the Commodity Exchange Act ("CEA"), and is an unjustified departure from the Commission's administrative precedent. AMG respectfully disagrees with the analysis of both the statutory and regulatory history concerning position aggregation in the Supplemental Aggregation NPRM. AMG has never argued that position aggregation cannot be required on the basis of ownership. AMG's argument, which the Supplemental Aggregation NPRM does not squarely address, is that ownership-based aggregation (absent trading control) must be based on ownership of a position, and not on ownership of an entity that owns a position.

In footnote no. 58, the Supplemental Aggregation NPRM offers two reasons for its presumption that ownership equates to control, and thus imposing an "aggregate unless you establish no control" approach rather than an "aggregate if you control" approach: 1) the possibility of circumvention;[17] and 2) the burden on the Commission.[18] Respectfully, AMG submits that neither of these reasons is sufficient to justify the application of an owned entity aggregation requirement to passive investors, who do not have control over owned entities by virtue of their *passive* ownership interest in those entities.

Possibility of circumvention: As noted above, the Commission itself has recognized that the public policy goals that position limits serve are impacted by trading control, not ownership. The Supplemental Aggregation NPRM speculates that some persons "may," or "could," use ownership to exert control in circumvention of the aggregation requirement.[19] Yet, neither the Initial nor the Supplemental Aggregation NPRM suggests that passive ownership of equities can be used to exert control over trading – or even explains how that might happen. This type of passive ownership is simply not an indicia of, nor does it create a risk of, control over the trading decisions of the owned entity. A general and hypothetical risk of circumvention does not justify an "aggregate unless you establish no control" approach, as opposed to an "aggregate if you control" approach, in the context of passive equity ownership.

Burden on the Commission: With respect to the potential burden on the Commission of having to apply an individualized control test, we note that the "facts and circumstances" approach abounds throughout the Commission's rules and case law.[20] The Commission has never shied away from making individual, fact-dependent determinations on such fundamental issues as whether a given transaction is a futures contract or a swap subject to its jurisdiction, and there is no reason that such an approach would be more burdensome in the context of position

[17] 80 Fed. Reg. at 58,371 n.58 (if aggregation were required "only if the existence of control were proven, market participants may be able to use an ownership interest to directly or indirectly influence the account or positon and thereby circumvent the aggregation requirement").

[18] *Id.* (if "there were no aggregation on the basis of ownership, [the Commission] would have to apply a control test in all cases, which would pose significant administrative challenges to individually assess control across all market participants").

[19] *Id.*

[20] AMG appreciates that the Commission's limited budget and scarce resources may make a bright-line ownership percentage an attractive approach for aggregation purposes. However, for the reasons discussed in this letter and in our First AMG Aggregation Letter, such an approach is not appropriate here. The Commission historically has eschewed such bright-line tests in favor of a "facts and circumstances" approach, and has done so in its rulemakings to implement the Dodd-Frank Act as well. *See, e.g., Further Definition of "Swap," "Security-Bases Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping,* 77 Fed. Reg. 48208, 48237 (August 13, 2012) ("Product Definitions Rulemaking") ("In evaluating whether an agreement, contract, or transaction qualifies for the forward contract exclusion[] from the swap definition for nonfinancial commodities, the [Commission] will look to the specific facts and circumstances of the transaction as a whole to evaluate whether any embedded optionality operates on the price or delivery term of the contract, and whether an embedded commodity option is marketed or traded separately from the underlying contract.").

aggregation. The desire for a bright-line test does not justify painting with so broad a brush as to sweep into position aggregation passive equity holdings that are not accompanied by any trading control.

For these reasons, we believe that the Commission should not require aggregation of an owned entity's positions by passive investors that have an ownership interest in that entity but that do not actually control the trading decisions of the owned entity.

C. At a Minimum, the Disaggregation Requirements Should be Modified, Consistent with Commission Precedents

The Proposal's "aggregate unless you establish no control" approach requires a filing with the Commission, and imposes fixed conditions to disaggregate, in all investment circumstances. If the Commission determines to retain that approach with respect to passive investors, at a minimum, AMG respectfully requests that the Commission modify the prescriptive filing requirement and rigid conditions to disaggregate an owned entity's positions in the context of passive investors. We propose two alternatives to the burdensome filing requirement, both of which find precedents in rules and guidance issued by the Commission.

Non-exclusive safe harbor: The Commission could replace the mandatory filing requirement with a non-exclusive safe harbor for passive equity ownership of another entity, based on what the Commission has done in other rulemakings. In the Product Definitions Rulemaking, for example, the Commission declined to set rigid definitions of insurance products, or consumer and commercial agreements, that are excluded from the definition of the term "swap." Instead, for insurance, the Commission provided a non-exclusive safe harbor based on the nature of the product and the nature of the provider, and stated that a failure to meet any of the requirements of the safe harbor does not mean that a particular transaction is a swap.[21] Similarly, the Commission provided an interpretation as to specific types of consumer and commercial agreements that fall outside the scope of the swap definition, and stated that this interpretation "is not intended to be the exclusive means" for consumers and commercial entities to determine whether their agreements fall within the swap definition.[22] Significantly, no notice is required to be filed with the Commission, no conditions are imposed, and no certifications need be made.

The Commission could apply this same safe harbor approach to position aggregation by passive investors. The five conditions set out in proposed rule 150.4(b)(2) would represent a safe harbor; where they are satisfied by a passive investor with respect to its activities concerning an owned entity, the investor would be assured that it may disaggregate that owned entity's

[21] 77 Fed. Reg. at 48,214 ("Such an agreement, contract, or transaction will require further analysis of the applicable facts and circumstances, including the form and substance of such agreement, contract, or transaction, to determine whether it is insurance, and thus not a swap . . .").

[22] *Id.* at 48,248 ("If there is a type of agreement, contract, or transaction that is not enumerated above, or does not have all the characteristics and factors that are listed above . . . the agreement, contract, or transaction will be evaluated based on its particular facts and circumstances.").

positions from its own. Other passive investors could look to the policy objectives underlying the safe harbor (*i.e.,* assuring independence in trading) and determine that, while they may not meet every element of the safe harbor, nevertheless, their trading is independent of that of the owned entity, and they could therefore conclude that aggregation is not required. In neither event would a filing or certification be required, since the Commission, as with the safe harbors established in the Product Definitions Rulemaking, would not be undertaking to pass upon such aggregation determinations.[23]

Alternatively, under such a safe harbor approach, the Commission could still require the filing of a notice and certification (which, under the proposed rule, would be effective upon submission), but only by those passive investors that do not satisfy the safe harbor. In either event, the safe harbor approach (whether it eliminates the filing requirement for passive investors entirely or eliminates it for those passive investors that satisfy the safe harbor) would provide needed flexibility into the proposed owned entity aggregation requirement. It would account for the prospect that passive investors, viewed in the context of their facts and circumstances, do not control the trading of entities in which they invest – but may not necessarily be able to satisfy the letter of the conditions mandated in the proposal. Given the Commission's use of such non-exclusive safe harbors for the fundamental question of whether a product is subject to Commission jurisdiction, there is no reason the same approach should not be used for the question of whether a passive equity owner of an owned entity must aggregate positons for position limits purposes.

To do otherwise would not only unduly burden passive investors, but impose a shifting responsibility upon passive investors to file when they are above an ownership threshold and withdraw that filing when they fall below that threshold. As stated above, passive investors do not necessarily control their ownership percentage and would need to monitor on an ongoing basis.

Less intrusive filing requirement: If the Commission rejects the use of a non-exclusive safe harbor and insists on a filing requirement, then it should allow for a simplified, generic omnibus filing that would provide the Commission with notice that an investor intends to rely on the exemption on a going-forward basis for its passive equity investments. Here, too, there is recent Commission precedent to support such an approach.

In adopting an exemption from various swap regulations for commodity trade options, the Commission did not require commercial end users to apply the full panoply of Part 45 of the Commission's regulations in order to report their trade options – but, rather, required a more limited form of reporting in Form TO. The Commission stated that "[t]he Form TO reporting

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[23] Indeed, the requirement that passive investors claiming the owned entity exemption file a description of the relevant circumstances supporting their eligibility for the exemption undermines the Proposal's stated objective of eliminating the Commission's burden to individually assess control in all cases. Either the Commission, despite its resource constraints, will be reviewing the filings and thus will still be individually assessing control with respect to passive investors even under its "aggregate unless you establish no control" approach, or it will not be reviewing them – in which case the filing is a burdensome obligation on passive investors, with no public policy benefit.

filing requirement will provide the Commission a minimally intrusive level of visibility into the unreported trade option market," and will "guide the Commission's efforts to collect additional information . . . should market circumstances dictate . . ."[24]

Similarly, if the Commission feels that it needs to know which passive investors are relying on the owned entity exemption based on their lack of control over the trading of an owned entity, the Commission should impose a "minimally intrusive level of visibility" through a simple, generic filing stating that the passive investor is relying on the exemption. Such filings, like those for trade options, would suffice to "guide" the Commission if it determined that it needed additional information in particular circumstances.[25]

III. The Commission Should Clarify Certain of the Independence Criteria

Whether the Commission retains the five criteria of independent trading control as conditions of an exemptive filing, or as a safe harbor, AMG also requests that it provide the following clarifications with respect to certain elements of those criteria:

Separately developed and independent trading systems: The second criterion of trading independence in the Proposal would require owned affiliates to "trade pursuant to separately developed and independent trading systems." The Initial Aggregation NPRM explained that this disaggregation criterion should be interpreted in accordance with the Commission's prior practices in this regard, and stated that:

> The Commission generally does not expect that this criterion would prevent an owner and an owned entity from both using the same "off-the-shelf" system that is developed by a third party. Rather, the Commission's concern is that trading systems (in particular, the parameters for trading that are applied by the systems) could be used by multiple parties who each know that the other parties are using the same trading system as well as the specific parameters used for trading and, therefore, are indirectly coordinating their trading.[26]

AMG supports this view and requests that the Commission reiterate this guidance related to the "separately developed and independent trading systems" criterion in any final rulemaking

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[24] *Commodity Options,* 77 Fed. Reg. 25,320, 25,328 (April 27, 2012). Recently, the Commission proposed to simplify trade option reporting by commercial end users even further, proposing to require that end users simply notify Commission staff by e-mail when they have entered, or intend to enter, trade options with a notional value exceeding $1 billion during the course of a calendar year. *See Trade Options,* 80 Fed. Reg. 26,200 (May 7, 2015).

[25] In response to Commissioner Giancarlo's request for comment regarding periodic filings, we strongly urge the Commission to clarify that any filing required to rely on the owned entity exemption need only be updated in the event of a material change in the originally submitted information on which that reliance is based. Such filings should not be required on a routine or periodic basis. To do so would only exacerbate the degree to which the costs associated with such a filing requirement, particularly in the case of passive investors, outweigh its benefits.

[26] 78 Fed. Reg. at 68,961-62.

adopting it as a criterion of trading independence. In addition, AMG requests that the Commission clarify that the above guidance is not limited to off-the-shelf systems or other technologies "developed by" third parties, but rather includes any in-house software or custom modules added to third-party software. Many large entities develop their own proprietary trading software or modify third-party off-the-shelf systems to support trade capture and documentation features that they may need. Once developed, the internal or third-party-modified software (but not underlying transaction data or actual positions) may be shared with, sold to, or licensed to affiliated entities. Provided that these internal systems are not used to share trading information with day-to-day trading personnel or otherwise permit coordinated trading, entities that employ such software should be eligible for the exemption from owned entity aggregation.[27]

Written procedures to preclude knowledge of, and access to, trading information: The third criterion of trading independence in the Proposal would require that the owner and the owned entity "[h]ave and enforce written procedures to preclude each from having knowledge of, gaining access to, or receiving data about, trades of the other." AMG requests that, at least with respect to passive investors, the Commission limit this criterion of trading independence to the owner, and not the owned entity, in any final rulemaking adopting it. As a practical matter, passive investors may not be able to determine and verify whether the owned entity has written procedures that are sufficient to meet the standards of this criterion, in which case they would not be able to rely on the owned entity exemption and would be required to aggregate positions. But this should not be necessary. As long as the owner has (and enforces) the requisite written procedures that preclude it from having knowledge of, gaining access to, and receiving data about, trades of the owned entity – and that maintain the independence of its trading activities from those of the owned entity – then the underlying objective of this criterion will be achieved.

Sharing of risk management systems: The fifth criterion of trading independence in the Proposal states that owned affiliates may "not have risk management systems that permit the sharing of trades or trading strategy." The Initial Aggregation NPRM explained that:

> [T]his [disaggregation] criterion generally would not prohibit sharing of information to be used only for risk management and surveillance purposes, when such information is not used for trading purposes and not shared with employees that . . . control, direct or participate in the entities' trading decisions. Thus, sharing with employees who use the information solely for risk management or compliance purposes would generally be permitted, even though those employees' risk management or compliance activities could be considered to have an "influence" on the entity's trading.[28]

AMG supports this view and requests that the Commission reiterate the above guidance related to the "risk management systems that permit the sharing of trades or trading strategy"

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[27] AMG also asks that any final rulemaking adopting this criterion of trading independence reiterate the guidance in the Initial Aggregation NPRM that "routine pre- or post-trade systems to effect trading on an operational level (such as trade capture, trade risk or order-entry systems) would not, broadly speaking, have to be independently developed in order to comply" with the conditions for owned entity disaggregation." *Id.* at 68,961.

[28] *Id.* at 68,962.

criterion in any final rule adopting it. The Commission also should confirm that disaggregation is permitted notwithstanding continuous sharing of position information, so long as such information is used only for risk management and surveillance purposes and is not shared with trading personnel.

In addition, the Commission should clarify that the disaggregation exemption is available to entities that share trading and position information for risk management purposes, even if such information is shared on a real-time basis and even if the entity's risk management systems or personnel have authority to require the reduction of positions to comply with internal credit or position limits, exchange limits, or government regulations. The Commission should confirm that entities may use shared risk management services, including real-time data sharing and position reduction mechanisms, so long as they do not permit coordinated or shared trading.

IV. The Commission Should Address Similar Concerns that Apply to IACs and Fund Investors

Several of the concerns discussed above with respect to owned entity aggregation are equally applicable to other aspects of the proposed position aggregation rules as well. For example, as we noted in the First AMG Aggregation Letter, the new filing requirement to claim the IAC exemption is no more warranted than the filing requirement to claim the owned entity exemption.[29] The Commission should adhere to its historical practice of not requiring such a filing for the IAC exemption. If it chooses to change course, though, it should allow for a simplified generic, omnibus filing that would provide the Commission notice that an eligible entity intends to use the exemption on a going-forward basis consistent with the terms of the exemption.

Further, if the Commission does not modify the treatment of Rule 4.13 exempt pools as requested above, investors in Rule 4.13 exempt pools will confront some of the same burdens and difficulties in applying the aggregation requirements as owners of other entities discussed above. For example, they may not have systems or procedures in place to monitor all the information necessary to comply with position limits. In addition, an investor in such a fund may not know what percentage ownership it has in that fund, and its ownership interest may change over time due to purchases or redemptions by other investors. However, such an investor would be required to aggregate the fund's positions with its own if the fund is a Rule 4.13 exempt pool and the investor has a 25% or greater ownership interest (even if the investor has no control over the fund's trading strategies). This presents a particular burden on the first or last investors in a pooled investment vehicle, who will necessarily have greater than a 25% interest for some period of time.

Above, we have reiterated the recommendation in our First AMG Aggregation Letter that passive investors with a 25% or greater ownership interest in a Rule 4.13 exempt pool under sub-paragraph (a)(3) (as is currently the case for unaffiliated passive investors in a non-exempt pool, and as we recommend above for passive investors in owned entities), not be required to aggregate the positions of the pool. If the Commission declines this recommendation, we

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[29] *See* First AMG Aggregation Letter at 15.

recommend that passive investors with a 25% or greater ownership interest in a Rule 4.13 exempt pool at least have the opportunity to obtain a disaggregation exemption by demonstrating its absence of actual trading control. And, as we recommend above with respect to passive investors in owned entities, we recommend that such a demonstration take the form of a non-exclusive safe harbor or, at a minimum, a less intrusive required filing.

Finally, because passive investors in a Rule 4.13 exempt fund may be unable to obtain information necessary to determine whether they meet the ownership threshold and are therefore required to aggregate, the Commission also should provide such investors with a reasonable period after receiving information establishing that they have crossed that threshold before subjecting them to the aggregation requirement. As noted above, passive investors should not be held to compliance obligations that, as a practical matter, are beyond their control to fulfill.

V. Recommendations

For the reasons discussed above, AMG respectfully recommends that:

1. The Commission harmonize its position aggregation requirements for passive investors by permitting passive investors with a 10% or greater ownership interest in an owned entity, and passive investors with a 25% or greater ownership interest in a Rule 4.13 exempt fund under sub-paragraph (a)(3), to disaggregate based on their lack of actual control over trading without having to make any filing or certification, as is the case for unaffiliated passive investors in non-exempt pools.

2. If final rules continue to require owned entity aggregation by passive investors,[30] and then provide an exemption when there is no trading control, the Commission revise the exemption in proposed rule 150.4(b)(2) to provide needed flexibility by making the five criteria of trading independence a safe harbor for passive investors, rather than conditions that must be satisfied in order to claim the owned entity exemption.

3. If the Commission imposes a filing requirement for passive investors to disaggregate the positions of an owned entity, it require:

[30] In the First AMG Comment Letter, we also recommended certain additional, non-exclusive changes to the proposed owned entity aggregation requirement that would reduce the cost to comply without forgoing meaningful regulatory benefit. If the Commission retains that requirement for passive investors, we renew our prior recommendations that the Commission: 1) allow for the *pro rata* allocation of positions within set bands of ownership percentages, which would be less costly for passive investors because it would provide them some proportionate degree of protection if their owned entity exceeds a position limit; and 2) permit passive investors to measure ownership interests on a predetermined basis (such as on quarterly dates), which would reduce the costs of complying with the proposed owned entity aggregation requirement and mitigate our members' concerns about disruptions to their clients' investments that could otherwise result from frequent changes in ownership interests.

a. A filing only when a passive investor seeks to disaggregate an owned entity's positions based on its facts and circumstances although it is not able to satisfy all the elements of the five criteria of trading independence; and/or

b. Only a simplified, generic omnibus filing that would provide the Commission with notice that a passive investor intends to rely on the exemption on a going-forward basis for its passive equity investments.

4. The Commission clarify the second, third, and fifth criteria establishing independent trading control in proposed rule 150.4(b)(2)(i) along the lines described above.

5. The Commission provide aggregation relief for IACs and investors in Rule 4.13 exempt pools along the lines described above.

These recommendations would present substantially reduced costs for AMG members and their clients and promote enhanced liquidity in commodity derivatives markets without diminishing the overall purposes of the position limits regime and without creating opportunities for circumvention of the aggregation requirement.[31]

* * *

For the reasons stated above, AMG recommends that the Commission not adopt the aggregation rules as proposed in light of the Supplemental Aggregation NPRM. Instead, the rules should be revised as discussed above in order to address their impact on passive investors that have no control over the specific commodity derivatives trading activities of entities – be they pools or operating companies – in which they have invested.[32]

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[31] 80 Fed. Reg. at 58,373.

[32] In addition to position aggregation issues, AMG's members also have a significant interest in, and have provided comments to the Commission regarding, other proposed amendments to the Commission's position limits rules. A copy of AMG's comment letter ("AMG Position Limits Letter") regarding the Commission's companion release, *Position Limits for Derivatives,* 78 Fed. Reg. 75,680 (Dec. 12, 2013), also is enclosed for informational purposes. AMG welcomed Chairman Massad's statement that the Commission is taking a closer look at relying on the exchanges to grant non-enumerated hedge exemptions. *See Remarks of Chairman Timothy Massad Before the Natural Gas Roundtable* (May 26, 2015), available at http://www.cftc.gov/PressRoom/Speeches/Testimony/opamassad-23. This position is consistent with the recommendation in AMG's Position Limits Letter that the Commission provide the exchanges "broader discretion" in determining exemptions, subject to Commission oversight, which would enable the exchanges "to more effectively and efficiently tailor[] these requirements to the individual commodity contract markets." AMG Position Limits Letter at 11. AMG's Position Limits Letter also urged the Commission to: 1) modify the proposed spot-month limits and withdraw or increase the non-spot-month position limit levels; 2) preserve the risk management exemption from speculative position limits; 3) grant counterparties to "commodity index contracts" an exemption for managing price risk associated with such positions; 4) exempt registered investment companies and ERISA accounts from speculative position limits; and 5) extend grandfather relief to pre-existing positions. AMG would welcome the opportunity to further discuss our comments on these issues with the Commissioners and the staff.

We appreciate your consideration of our comments. We stand ready to provide any additional information or assistance that the Commission might find useful. Should you have any questions, please do not hesitate to contact Tim Cameron at 202-962-7447 or tcameron@sifma.org, Laura Martin at 212-313-1176 or lmartin@sifma.org, or Terry Arbit at Norton Rose Fulbright at 202-662-0223 or terry.arbit@nortonrosefulbright.com.

Respectfully submitted,

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Enclosures:
1) First AMG Comment Letter Regarding Notice of Proposed Rulemaking – Aggregation of Positions (RIN 3038-AD82), February 10, 2014
2) Second AMG Comment Letter Regarding Notice of Proposed Rulemaking – Aggregation of Positions (RIN 3038-AD82), August 1, 2014
3) AMG Initial Comment Letter Regarding Notice of Proposed Rulemaking – Position Limits for Derivatives (RIN 3038-AD99), February 10, 2014

cc (w/encl):
Honorable Timothy G. Massad, Chairman
Honorable Sharon Y. Bowen, Commissioner
Honorable J. Christopher Giancarlo, Commissioner
Mr. Vincent McGonagle, Director, Division of Market Oversight
Mr. Stephen Sherrod, Senior Economist, Division of Market Oversight
Ms. Riva Spear Adriance, Senior Special Counsel, Division of Market Oversight
Mr. Jonathan Marcus, General Counsel
Mr. Mark Fajfar, Assistant General Counsel

Enclosure 1

| asset management group

February 10, 2014
Melissa Jurgens
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington DC 20581

Re: Notice of Proposed Rulemaking – Aggregation of Positions (RIN 3038-AD82)

The Asset Management Group ("AMG")[1] of the Securities Industry and Financial Markets Association ("SIFMA") appreciates the opportunity to provide the Commodity Futures Trading Commission (the "Commission") with comments regarding the "Aggregation of Positions" proposed rulemaking ("2013 Aggregation NPRM").[2] We believe that the Commission has made some positive steps in this 2013 Aggregation NPRM, but we have some significant concerns with respect to certain aspects of the proposal, in the following areas in particular:

- ***Owned Entity Aggregation.*** The Commission should not adopt the owned entity aggregation as proposed. Requiring passive investors, which include, without limitation, registered and private commodity pools and other investment vehicles, pension funds and other institutional clients of asset managers, that have no control over, or even knowledge of, the specific commodity derivatives trading activities of owned entities they have invested in to aggregate the positions of such entities would impose significant costs that would unnecessarily diminish their ability to provide valuable capital investment and generate returns for their beneficiaries and participants, exceeds the scope of the Commission's position aggregation authority under the Commodity Exchange Act ("CEA"), and is an unwarranted departure from the Commission's historical aggregation approach. The proposed exemptions from this owned entity aggregation requirement under proposed rules 150.4(b)(2) (10 to 50% ownership) and (b)(3) (above 50% ownership) do not sufficiently address the flaws of the proposed approach to aggregating owned entity positions in the passive investment ownership context.

[1] The AMG's members represent U.S. asset management firms whose combined assets under management exceed $20 trillion. The clients of AMG member firms include, among others, registered investment companies, ERISA plans, and state and local government pension funds, many of whom invest in commodity futures, options, and swaps as part of their respective investment strategies.

[2] 78 Fed. Reg. 68,946 (Nov. 15, 2013).

- ***Investment in Accounts or Pools with "Substantially Identical Trading Strategies."*** The Commission should not adopt the aggregation requirement in proposed 150.4(a)(2) for investments in funds that follow "substantially identical trading strategies" regardless of common trading control, significant ownership, or even knowledge of the relevant investments. This proposal is vague and lacks sufficient statutory, policy, and cost-benefit rationale.

- ***Passive Investors in Commission Regulation 4.13 Exempt Pool Aggregation Requirement.*** We recommend that the Commission amend 150.4(b)(1)(iii) to only require passive investors to aggregate positions of a Commission regulation 4.13 exempt pool based on a 25% or more ownership interest when "the operator of which is exempt from registration _under §§ 4.13(a)(1) or (a)(2)_" in order for this requirement to apply to its intended targets.

- ***Independent Account Controller Exemption.*** We recommend that the Commission extend "independent account controller" eligibility to registered commodity pool operators ("CPOs"), exempt CPOs, and exempt and excluded commodity trading advisors ("CTAs"). We also question the utility of the burdensome requirement on asset managers to submit notice filings to claim the independent account controller exemption.

1. Owned Entity Aggregation

Consistent with current 17 CFR 150.4(a), under proposed 150.4(a)(1), a person would be required to aggregate "positions in accounts" in which the person "directly or indirectly" has more than a 10% ownership interest. The Commission further proposes to interpret "accounts or positions" to include "accounts or positions" of third party[3] owned entities.[4] The Commission interprets ownership of another entity, standing alone, as providing a separate and distinct basis to require aggregation of the positions owned by the owned entity, regardless of actual control of such trading accounts.[5] That is, the Commission interprets the "ownership prong" of CEA section 4a(a)(1) to apply to accounts owned by owned entities if a person has an ownership interest greater than 10% in that owned entity (and otherwise does not have trading control or have a direct ownership interest in the owned entity accounts themselves).[6]

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[3] We use the term "third party" to refer to any person that is separate from another person. A person can have relationships with many types of third parties, e.g., an owned entity, an entity it does not have an ownership interest in but whose trading it controls, etc.

[4] *See* proposed 150.4(b)(2) (providing for an exemption from aggregation requirements for positions in accounts of an owned entity when the ownership interest in the owned entity is between 10 and 50% of total equity). *See also* 78 Fed. Reg. at 68,959.

[5] *Id.* citing 77 Fed. Reg. at 31,773.

[6] *Id.* ("The Commission continues to believe, as stated in the Part 151 Aggregation Proposal, that an equity or ownership interest above 50% constitutes a majority ownership or equity interest of the owned entity and is so significant as to justify aggregation under the ownership prong of Section 4a(a)(1) of the CEA.")

For the reasons set forth below, we recommend that the Commission reconsider its proposed owned entity aggregation rules. We present our specific recommendations in section 1.3 below.

1.1. Requiring passive investors that have no control over, or even knowledge of, the specific commodity derivatives trading activities of owned entities to aggregate the positions of such entities will be unduly costly.

While asset management companies would not generally need to aggregate customer positions managed by independent account controllers under proposed 150.4(b)(5)'s independent account controller ("IAC") exemption, individual IAC or non-IAC asset managers often invest customer assets (either directly or through investment vehicles) in entities that trade in commodity derivatives. Under the Commission's proposed 150.4(a), 10% or more ownership in a trading account may be sufficient to warrant aggregation. In this case, under the Commission's interpretation of the term "account,"[7] a purely passive holder of equity securities would be required to aggregate the positions of all entities of which it has beneficial equity ownership of 10% or more, unless it perfects an exemption to owned entity aggregation (most pertinently under proposed 150.4(b)(2) or (b)(3)). An arbitrary owned entity aggregation threshold at 10% ownership is vastly over-inclusive even if it is used as indicia of corporate control;[8] the Commission itself points out that corporate "control" is imputed at 50% or more ownership for the purpose of pre-merger notifications to federal regulators under the Hart–Scott–Rodino Antitrust Improvements Act.[9]

Passive investors of the type managed by AMG members do not have control over owned entities by virtue of their *passive* ownership interest in a legal entity. As such, they would typically only have minimal knowledge of these owned entities' trading positions and decisions.[10] The 2013 Aggregation NPRM would create a new standard of care for passive investors: they would have to determine whether and to what extent the owned entity (and all of its owned entity affiliates) trade in commodity derivatives and if so, act to perfect an exemption. If no exemption is available, then the passive investor would have to obtain reliable commodity

[7] We believe this reading would constitute an unexplained change from Commission administrative precedent. *See* section 1.4 below.

[8] As discussed below in section 1.7, the appropriate control standard under Commission position limits rules relates to trading control, not corporate control.

[9] 78 Fed. Reg. at 68,958, *citing* 16 CFR 801.1(b).

[10] Under some circumstances, when a passive investor (for example an Employee Retirement Income Security Act ("ERISA") plan) makes an investment in an entity, the investor's fiduciary duties (for example, as created under ERISA) could very well entail making prudent inquiries into the trading activities and investments of the owned entity. *See Harley v. Minnesota, Mining and Manufacturing Co*., 898 F. Supp. 2d 898, 906 (D. Minn. 1999) ('[A] fiduciary is required to undertake an independent investigation into the merits of an investment and to use appropriate, prudent methods in conducting the investigation."), *aff'd,* 284 F.3d 901 (8th Cir. 2002), *cert. denied,* 537 U.S. 1106 (2003); 29 CFR § 2550.404a-1(b)(2) (providing that an investment fiduciary, when evaluating an investment, must take into consideration the risk of loss associated with the investment).

derivatives position information from the entities in which it invests and is required to aggregate in order to ensure compliance with speculative position limits. In addition, these passive investors would have to develop, often from scratch, costly position monitoring infrastructure and hire or train staff to apply that infrastructure to the derivatives positions of their investments in order to ensure compliance with position limits. These costs to passive investors would deter investment in businesses that own commodity positions and are not offset by any commensurate benefit, especially in terms of reduced likelihood of excessive speculation or manipulation.

1.2. The proposed owned entity aggregation exemptions provide inadequate relief for passive investors and do nothing to further the goals Congress directed the Commission to achieve in promulgating position limits.

The Commission proposes two exemptions to the proposed general rule that requires a person to aggregate accounts owned by a third-party entity where such person has a greater than 10% ownership in the owned entity:

1. Under proposed 150.4(b)(2), the Commission proposes an aggregation exemption for ownership interests of up to 50% of an entity's equity under certain conditions. The owner and the owned entity ("Related Entities") must not have knowledge of one another's trading decisions and have in place protections to ensure independence, including: (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 before a trade is made. This exemption is effective upon submission of a notice filing under proposed 150.4(c)(1).

2. Under proposed 150.4(b)(3), the Commission proposes an aggregation exemption for ownership interests above 50% ownership under certain conditions. These conditions include all of those described above for ownership interests at and below 50% ownership, plus: (1) certification that the Related Entities' financial results are not consolidated in a financial statement pursuant to relevant accounting rules; (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. This exemption must be approved by the Commission or staff operating under delegated authority in order to become effective under proposed 150.4(c)(2).

These two exemptions would provide inadequate relief for passive investors and would do nothing to further the goals Congress directed the Commission to achieve in promulgating position limits.

First, while a move in the right direction, the proposed 150.4(b)(2) exemption from aggregation for ownership interests of up to 50% in the owned entity does not extend to all ownership interests and would require a burdensome notice filing in all investment circumstances, regardless of the absence of common trading control, for no apparent benefit. By

contrast, passive investors in a pool that are not affiliated with the pool operator under proposed 150.4(b)(1) would not be required to submit a notice filing to disaggregate the positions of pools in which they have invested, regardless of their ownership interest in the pool. Again, the 2013 Aggregation NPRM provides no reason why passive investors in owned entities should not have at least the same degree of deference.

Second, the proposed application-based exemption from aggregation in 150.4(b)(3) for ownership interests in excess of 50% is, as a practical matter, unworkable. Passive investors cannot plan their investment and compliance programs around a disaggregation application filing that depends on Commission approval which, even if granted, may take weeks or months to issue, while their managers may need to make immediate investment decisions.

Moreover, the conditions imposed on the proposed 150.4(b)(3) exemption seriously constrain its utility. This is particularly true of the condition prohibiting consolidation of financial results. The fact that an investor consolidates the financial results of the firms in which it invests is not indicative of trading control; earning returns on an investment is the main reason an investor invests. In addition, the requirement that the owned entity's positions not exceed 20% of any position limit effectively subjects owned entities to lower position limits.[11] The 2013 Aggregation NPRM makes no findings that this restriction furthers any of the goals Congress directed the Commission to achieve in promulgating position limits rules under CEA sections 4a(a)(2)(C) and 4a(a)(3)(B).

1.3. The Commission should reconsider its owned entity aggregation requirements.

For reasons stated in more detail in section 1.4 below, we believe the Commission's proposed owned entity aggregation requirements are legally flawed and based on an erroneous interpretation of the CEA and applicable administrative precedent. We recommend, therefore, that the Commission re-examine the 2013 Aggregation NPRM and substantially amend the proposed 150.4(b)(2) and (3) exemptions to achieve a more appropriate balance among the six statutory factors that the CEA requires the Commission to address when promulgating any position limit rules,[12] by:

[11] The alternative requirement that all of the owned entity's positions be bona fide hedging positions is not an independent condition. CEA section 4a(c)(1) prohibits the Commission from restricting the bona fide hedging positions of any trader: "No rule, regulation, or order issued under subsection (a) of this section shall apply to transactions or positions which are shown to be bona fide hedging transactions[.]" CEA section 4a(c)(1). Therefore, the limitation that an owned entity's positions be limited entirely to bona fide hedging positions is simply a sub-set of the requirement that would restrict speculative positions up to 20% of any limit.

[12] These factors include the "goals" stated in CEA section 4a(a)(2)(C), i.e., "striv[ing] to ensure" that (Factor 1) "trading on foreign boards of trade in the same commodity will be subject to comparable limits" and (Factor 2) "that any limits to be imposed by the Commission will not cause price discovery in the commodity to shift to trading [to FBOTs]." They also include the four additional factors that CEA section 4a(a)(3)(B) directs the Commission to balance when exercising its CEA section 4a(a)(2) authority: (1) (Factor 3) to diminish, eliminate, or prevent excessive speculation causing sudden or unreasonable fluctuations or unwarranted changes in price; (2) (Factor 4) to deter and prevent market manipulation, squeezes, and corners; (3) (Factor 5) to ensure sufficient market liquidity for bona fide hedgers; and (4) (Factor 6) to ensure that the price discovery function of the underlying market is not disrupted.

1. Extending the relief provided to passive investors in commodity pools under current 150.4(c) and proposed 150.4(b)(1) to passive investors in owned entities that do not have actual trading control of the owned entity's derivatives trading; and

2. Extending the owned entity exemption at proposed 150.4(b)(2) to include all third party ownership interests (greater than 50%) that do not involve actual common trading control.

In addition, we recommend three additional, non-exclusive changes that would reduce the cost to comply without forgoing meaningful regulatory benefit under the six statutory factors referenced above:

Filing requirements: The Commission should only require a 150.4(c)(1) notice filing when there is majority ownership in addition to indicia of trading control, e.g., a common business purpose relating to derivatives trading or the commercial use of commodities. The Commission's proposed 150.4(c)(2) application procedure should be omitted altogether or reserved for instances where there is majority ownership in addition to a trading control. In any event, a passive investor that holds an equity investment of any amount in an operating company that it has no trading control over should not be required to make any type of filing. If the Commission insists on a filing requirement for passive investors, then it should allow for a simplified, generic omnibus filing that would provide the Commission with notice that a passive investor intends to use the exemption on a going-forward basis consistent with the terms of the exemption for its passive equity investments.

Pro rata attribution of positions: The Commission should allow for the *pro rata* attribution of positions based on ownership interest. *Pro rata* allocation of positions would be less costly for passive investors because it would provide them some proportionate degree of protection if their owned entity exceeds a position limit. For example, for a passive investor with a 15% ownership interest in an owned entity that exceeds a position limit, an allocation of 15% or even 25% of that owned entity's positions would reduce the risk of an inadvertent position limits overage. Accordingly, we recommend *pro rata* allocation of ownership interests within set bands of ownership percentages.

Quarterly measurement: The costs of complying with the Commission's proposed aggregation rules would also be reduced if the Commission provided a safe harbor to passive investors to measure ownership interests on a predetermined basis, such as on quarterly dates. Permitting passive investors to measure ownership interests on a fixed and workable schedule will not undermine the Commission's position limits regime. This approach would mitigate our members' concerns about disruptions to their clients' investments that could otherwise result from frequent changes in ownership interests.

These recommendations would present substantially reduced costs for AMG members and their clients yet would still ensure at least the same degree of efficacy of the Commission's position limits regime under the goals provided by Congress in CEA sections 4a(a)(2)(C) and 4a(a)(3)(B) by providing passive investors with legal certainty that would promote liquidity in

commodity derivatives. In fact, the Commission's proposal would increase the potential for coordinated manipulative trading activity because it mandates common trading control where none currently exists.

1.4. Requiring passive investors that have no control over, or knowledge of, the specific commodity derivatives trading activities of owned entities they have invested in to aggregate the positions of such entities has not been justified.

1.4.1. Requiring passive investors that have no control over, or knowledge of, the specific commodity derivatives trading activities of owned entities they have invested in to aggregate the positions of such entities exceeds the scope of the Commission's position aggregation authority under the CEA.

The 2013 Aggregation NPRM states its basis for requiring the aggregation of owned entity positions regardless of the existence of common trading control as follows (emphasis added):

> In light of the language in section 4a, its legislative history, subsequent regulatory developments, and the Commission's historical practices in this regard, the Commission continues to believe that section 4a requires aggregation on the basis of *either ownership or control of an entity*.[13]

The relevant portion of CEA section 4a(a)(1) provides (emphasis added):

> [T]he positions held and trading done by *any persons directly or indirectly controlled by such person* shall be included with the positions held and trading done by such person; and further, such limits upon positions and trading shall apply to positions held by, and trading done by, two or more persons acting pursuant to an expressed or implied agreement or understanding, the same as if the positions were held by, or the trading were done by, a single person.

CEA section 4a(a)(1), by its terms, requires aggregation of positions held and trading done by third parties only when the other person is "*directly or indirectly controlled*."[14] This is not a situation where the CEA is silent about aggregating the positions of third parties (including owned entities) so that the Commission might fill the gap by inferring that the "ownership prong" applies to positions held by an owned third party; rather, the statute specifically addresses the conditions under which a third party's positions are to be aggregated, i.e., when the positions

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[13] 78 Fed. Reg. at 68,956.

[14] In the first critical clause quoted above, the phrase "any person" refers to a third party, whereas the phrase "such person" refers to the principal person subject to this statutory aggregation provision. Thus, re-phrasing the clause slightly for purposes of clarification, the positions held and trading done by a third party (e.g., the company in which an investor invests) directly or indirectly controlled by a person (e.g., the investor) shall be included with the positions held and trading done by that person (e.g., the investor). By contrast, the "ownership prong" that appears immediately after this first clause applies only to directly held positions ("positions held and trading done by such person," e.g., the investor).

held and trading done by the third party are "directly or indirectly controlled." With respect to positions held and trading done by third parties, CEA section 4a(a)(1) imposes a constraint on the Commission's authority to require aggregation. CEA section 4a(a)(1) provides that the aggregation of positions held and trading done by third parties is to occur only when the positions held and trading done by the third party are "directly or indirectly controlled" ("Third Party Aggregation Constraint").

The statutory Third Party Aggregation Constraint is consistent with the legislative history of CEA section 4a. As cited in the Commission's 2012 "Aggregation, Position Limits for Futures and Swaps" proposed rulemaking,[15] a 1968 Senate Report provides that "Section 2 of the bill amends section 4a(1) of the [CEA] to show clearly the authority to impose limits on […] trading done and positions held by *a person controlled by another* shall be considered as done or held by" a person (e.g., the investor).[16]

1.4.2. Requiring passive investors that have no control over, or knowledge of, the specific commodity derivatives trading activities of owned entities they have invested in to aggregate the positions of such entities is an unwarranted departure from the Commission's historical aggregation approach.

The Commission interprets 17 CFR 150.4(b) and proposed Commission regulation 150.4(a) as requiring the aggregation of owned entity positions.[17] The Commission, however, has never promulgated rules (that were not vacated) in which it has interpreted "accounts" to encompass accounts owned by third parties that are commonly owned but not commonly controlled. All of the Commission's pre-2011 position aggregation rulemakings required aggregation on the basis of direct ownership in accounts, not ownership interests in third parties who, in turn, own positions in derivatives trading accounts.

For example, the Commission's 1979 Statement of Aggregation Policy is squarely focused on ownership of accounts, not ownership in entities that own accounts.[18] Its first point stated that "[e]xcept for a limited partner or shareholder in a commodity pool, any person who has a 10% or more financial interest *in an account* will be considered as an account controller" (emphasis added).[19] The 1979 Statement of Aggregation Policy defines "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…"[20]

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[15] 77 Fed. Reg. 31,767 (May 30, 2012).

[16] *Id.* at 31,772 at fn. 80, citing S. Rep No. 947, 90th Cong., 2 Sess. 5 (1968) (emphasis added).

[17] Proposed 150.4(a) ("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% or greater ownership or equity interest, must be aggregated with the positions held and trading done by such person.").

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

[19] *Id.* at 33,845.

[20] *Id.*

The 2013 Aggregation NPRM presents the following quote from a position limits rulemaking from 1999 in an attempt to support its interpretation that CEA section 4a(a)(1)'s "ownership prong" includes ownership of third parties' accounts: "the Commission . . . interprets the 'held or controlled' criteria [of CEA section 4a] as applying separately to ownership of positions or to control of trading decisions."[21] However, this quote does not refer to accounts of owned entities. This is not surprising as, again, this 1999 rulemaking was squarely focused on the aggregation of directly owned accounts – and not of accounts owned by an owned third party. For example, the 1999 rulemaking provided that when a person "holds or has a financial interest in or controls more than one account, all such accounts shall be considered by the futures commission merchant, clearing member or foreign broker as a single account…"[22] Thus, neither the quote nor the rulemaking from 1999 support the interpretation in the 2013 Aggregation NPRM.

Contrary to the assertion of the 2013 Aggregation NPRM, the Commission has in fact clearly distinguished between ownership of accounts, on the one hand, and ownership in third party entities that themselves own accounts, on the other. In the context of its CFTC Form 40 rules at 17 CFR 18.04(a)(8), the Commission requires the reporting of information relating to "persons… who have a financial interest of 10% or more in the [Form 40] reporting trader *or* the accounts of the reporting trader" (emphasis added). If financial interests in "accounts" encompassed financial interests in accounts of other persons, then the Commission would have had no need to separately articulate the requirement to report financial interests in the accounts of a reporting trader and the requirement to report financial interests in the reporting trader itself.

The Commission's historical definition of "account" in the position aggregation context is consistent with other Commission regulations that also similarly define the term "account." For example, 17 CFR 39.2 defines "customer account" as meaning "a clearing member account held on behalf of customers, as that term is defined in this section, and which is subject to section 4d(a) or section 4d(f) of the [CEA]" and "house account" as meaning "a clearing member account which is not subject to section 4d(a) or 4d(f) of the [CEA]." 17 CFR 1.3(vv) defines "futures account" to mean an "account that is maintained in accordance with the segregation requirements of sections 4d(a) and 4d(b) of the [CEA] and the rules thereunder." None of these regulations define an "account" as encompassing accounts of owned entities.

The one exception is the Commission's definition of "proprietary account" in 17 CFR 1.3(y),[23] which is defined explicitly to include accounts held by "business affiliates."[24] This term

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[21] 78 Fed. Reg. at 68,956, *quoting* Revision of Federal Speculative Position Limits and Associated Rules, 64 Fed. Reg. 24,038, 24,044 (May 5, 1999).

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

[23] 17 CFR 1.3(y) "*Proprietary account*. This term means a commodity futures, commodity option, or swap trading account carried on the books and records of an individual, a partnership, corporation or other type of association: (1) for one of the following persons, or (2) of which ten percent or more is owned by one of the following persons, or an aggregate of ten percent or more of which is owned by more than one of the following persons:

[...]

is cited as support for the Commission's new interpretation of the term "account" in the position limits context.[25] The term "proprietary account," however, is irrelevant to the position limits context. The term "proprietary account" is used in 17 CFR 155.3, which requires that a futures commission merchant ("FCM") give priority to executing customer orders over orders from any "proprietary account." Moreover, the fact that the term "proprietary account" is explicitly defined to include accounts held by "business affiliates" suggests that in the Commission's regulations, the term "account," standing alone, does not include accounts of owned entities but rather refers only to directly held or controlled trading accounts.

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 derivatives trading control. The import of the Commission's Order settling an administrative enforcement action in September 2010 against Vitol Inc. and one of its affiliates for false statements in connection with NYMEX position aggregation rules (which parallel Commission rules),[26] is that control was a pre-requisite in considering whether Vitol Inc. was required to aggregate the positions of its commonly-owned affiliate.[27] The recitation of facts in the Commission's Order

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> (viii) A business affiliate that, directly or indirectly is controlled by or is under common control with, such individual, partnership, corporation or association: P*rovided, however*, That an account owned by any shareholder or member of a cooperative association of producers, within the meaning of section 6a of the [CEA], which association is registered as a futures commission merchant and carries such account on its records, shall be deemed to be an account of a customer and not a proprietary account of such association, unless the shareholder or member is an officer, director or manager of the association."

[24] 17 CFR 1.3(y)(1)(viii).

[25] 78 Fed. Reg. 68,956 citing 17 CFR 1.3(y).

[26] "Ownership of Accounts – Except as set forth in Section E. below, any person holding positions in more than one account, or holding accounts or positions in which the person by power of attorney or otherwise directly or indirectly has a 10% or greater ownership or equity interest, must aggregate all such accounts or positions unless such person is a limited partner, shareholder, member of a limited liability company, beneficiary of a trust or similar type of pool participant in a commodity pool. […]." CME Rule 559.D.2, available at http://www.cmegroup.com/rulebook/CME/I/5/5.pdf. Certain commodities are currently subject only to position limit rules set by designated contract markets ("DCMs"). Aggregation for purposes of DCM-set position limits today is governed by Core Principle 5 "Position Limitations or Accountability" in CEA section 5(d)(5) and subpart F of 17 CFR part 28. CEA section 5(d)(1)(B) provides that DCMs have "reasonable discretion in establishing the manner in which the board of trade complies with the core principles described in this subsection" unless "otherwise determined by the Commission by rule or regulation." Under 17 CFR 38.301, DCMs "must meet the requirements of parts 150 and 151 of this chapter, as applicable." The only Commission regulation that relates to the aggregation of positions for exchange-set position limits (and that was not vacated) is 17 CFR 150.5(g). 17 CFR 150.5(g) provides that DCMs must aggregate on the basis of control and does not prescribe any other standard:

> In determining whether any person has exceeded the limits established under this section, all positions in accounts for which such person by power of attorney or otherwise directly or indirectly controls trading shall be included with the positions held by such person[.]

[27] 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/enfvitolorder09142010.pdf. In this matter, the Commission found that Vitol Inc. and its affiliate willfully failed to correct NYMEX's misperception of the "true nature of the relationship between" Vitol Inc. and its affiliate and imposed a civil monetary penalty of $6 million.

focused on Vitol Inc.'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 commonly owned Vitol affiliates.[28] These facts would have been relevant only if common control were a pre-condition to the application of the position aggregation rules (as it is due to the statutory Third Party Aggregation Constraint). Tellingly, no facts relating to common ownership were included in the Order.[29]

1.4.3. The 2013 Aggregation NPRM uses an inappropriate baseline in considering the costs and benefits of its proposed owned entity aggregation rules.

In its discussion of "Cost-Benefit Considerations," the 2013 Aggregation NPRM states that its proposed owned entity aggregation policy is "more permissive than the 10% [owned entity position aggregation] threshold currently provided."[30] It therefore assumes a cost-benefit baseline that requires aggregation of positions for position limit compliance purposes based solely on ownership, regardless of the existence of common control.

This is an inappropriate baseline for two important reasons. First, as described above, neither the Commission nor DCMs (which currently are the sole administrators of position limits for all but nine agricultural commodities, including 19 of the 28 "referenced contracts"), currently require the aggregation of owned entity positions regardless of the existence of common control. Therefore, the Commission's proposal is more restrictive, not "more permissive" than (and, indeed, a dramatic departure from) the existing position aggregation regime. Second, speculative positions outside of the spot month have not been subject to position limits in 19 of the 28 "referenced contract" markets the Commission proposes to subject to position limits under an accompanying release.[31] Aggregating non-spot-month positions of entities in which passive investors make investments presents considerable new challenges, which have not been adequately considered by the 2013 Aggregation NPRM.

1.4.4. "Control" in the context of position aggregation requirements means actual control of derivatives trading, not of anything else, and therefore the owned entity aggregation requirements cannot be based on a theory of corporate control.

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[28] *Id.*

[29] *See also* Order Instituting Proceedings Pursuant to Sections 6(c) and 6(d) of the Commodity Exchange Act, as Amended, Making Findings and Imposing Remedial Sanctions, at 4, http://www.cftc.gov/ucm/groups/public/@lrenforcementactions/documents/legalpleading/enfcitigroupcgmlorder092112.pdf (Sept. 21, 2012) (finding that Citigroup was liable for the position limits violation of its subsidiary Citigroup Global Markets not on the basis of owned entity aggregation requirements under 17 CFR 150.4(b), but rather on the basis of an agency theory (CEA section 2(a)(1)(B) and 17 CFR 1.2).

[30] 78 Fed. Reg. at 68,968.

[31] 78 Fed. Reg. at 75,826. AMG is commenting separately on this proposal, including proposed 150.5(a)(5) providing that aggregation requirements of exchanges must "conform to" those of the Commission under proposed 150.4.

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As noted above, the 2013 Aggregation NPRM bases its proposed owned entity aggregation rules solely on CEA section 4a(a)(1)'s "ownership prong." The 2013 Aggregation NPRM suggests in defense of the 50% ownership aggregation exemption threshold in proposed 150.4(b)(2) that an ownership interest of greater than 50% "is indicative of control" and therefore warrants aggregation of an owned entity's positions even in the absence of any actual trading control. This conclusion appears to be based on conflated notions of corporate control in other contexts with trading control in the position limits context. The Commission cites a 50% equity ownership threshold used by the Federal Trade Commission and Department of Justice as "reflect[ing] a general understanding that ownership at this level poses substantial potential for direct or indirect control over an owned entity."[32] This threshold is used by these other government agencies to identify potential instances of common corporate control for the purpose of anti-trust filing requirements, not of common derivatives trading control.[33] Speculative position limits aggregation requirements are based on whether ownership is indicative of derivatives *trading control*, not corporate control.

The Commission has traditionally interpreted "control" in CEA section 4a(a)(1) and its predecessors as control of trading, not of corporate control or any other concept of control. For example, the Commission's current IAC exemption to position aggregation requirements focuses on the controller's independent control of trading decisions and lack of knowledge of the trading decisions of any other IAC.[34] Indeed, the 2013 Aggregation NPRM appropriately models the conditions for the owned entity aggregation exemption in proposed 150.4(b)(2) on the conditions for the IAC exemption, i.e. factors that demonstrate independent trading control. Similarly, the Commission's definition of "controlled account" at 17 CFR 1.3(j) means an account for which a person "actually directs trading."[35] Perhaps most important of all, the terms of the Commission's proposal appear to focus on trading control, not corporate control. The Commission's proposed general aggregation rule (150.4) requires aggregation when a person "directly or indirectly controls *trading*."

Thus, even if the Commission were to abandon the ownership theory relied upon in the 2013 Aggregation NPRM for a control theory instead, the result is the same: the proposal provides no basis for the Commission to depart from its historical view that position aggregation is required only where actual common trading control exists, e.g., when an investor controls the derivatives trading that occurs in a an owned entity's accounts.[36]

[32] 78 Fed. Reg. at 68,958, *citing* 16 CFR 801.1(b).

[33] *See* 16 CFR 802.2.

[34] 17 CFR 150.1(e).

[35] *See also* CFTC Form 102, available at http:// www.cftc.gov/ucm/groups/public/@forms/documents/file/cftcform102.pdf (prompting FCMs and others to identify "controlled accounts" of the same advisor exceeding "special account" activity thresholds).

[36] 78 Fed. Reg. at 68,958.

2. Passive Investment in Commission Regulation 4.13 Exempt Commodity Pools

2.1. The passive 17 CFR 4.13 exempt pool investor aggregation requirement should be omitted.

The 2013 NPRM proposes to require aggregation of positions in a 17 CFR 4.13 pool when a person holds a greater than 25% ownership interest in the pool under proposed 150.4(b)(1)(iii). This proposed rule is identical to current Commission rule 150.4(c)(2)(iii). The rationale for the current rule was that when there are "10 or fewer limited partners or when a limited partner has an ownership interest of 25% or greater, the limited partner" should be required to aggregate the positions of the pool.[37] The Commission was particularly concerned about single-investor pools when it adopted this requirement.[38] The only sub-paragraphs of current 17 CFR 4.13 that encompass the intended targets of this provision are sub-paragraphs (a)(1) and (a)(2). We therefore recommend that the Commission amend 150.4(b)(1)(iii) to apply to pools "the operator of which is exempt from registration *under §§ 4.13(a)(1) or (a)(2)*" in order for this requirement to apply to its intended targets.

3. Investment in Accounts or Pools with "Substantially Identical Trading Strategies"

Proposed 150.4(a)(2) provides that holding or controlling trading in more than one account or pool (collectively "funds") with "substantially identical trading strategies" requires aggregation ("SITS Rule"). This requirement would apply notwithstanding any other applicable aggregation exemption. In other words, the proposed SITS Rule would apply regardless of common control, significant ownership, or even knowledge of the relevant investments in funds with "substantially identical trading strategies."

The proposed SITS Rule should be omitted from any final rulemaking because it lacks sufficient rationale and is unworkable in practice, as discussed below. In the alternative, proposed 150.4(a)(2) should be amended to apply to "any person that, by power of attorney or otherwise, ~~holds or~~ directly controls the trading of positions" in a SITS account or pool.

3.1. The proposed SITS Rule lacks rationale.

The Commission does not provide a statutory or policy rationale for the proposed SITS Rule in the 2013 Aggregation NPRM or its 2012 predecessor.[39] The Commission's 2011 "Position Limits for Futures and Swaps" final rulemaking did contain a short rationale for a similar requirement for investments in funds with "identical trading strategies."[40] This provision, the Commission stated, was "intended to prevent circumvention of the aggregation requirements.

[37] 64 Fed. Reg. at 24,044.

[38] *Id.*

[39] There are, however, four mentions of the "identical trading strategies" rule in footnotes to the 2012 proposal. *See* e.g., 77 Fed. Reg. at 31,769 at fn. 14.

[40] *See* vacated 151.4(d).

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."[41] However, the 2011 rulemaking provided no historical example of any such circumvention.[42]

Finally, the 2013 Aggregation NPRM fails altogether to consider the costs and benefits of the 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.

3.2. The proposed SITS Rule is unworkable in practice.

As a consequence of the proposed SITS Rule, a $10,000 investor in two $1 billion commodity index mutual funds using the same index may have to aggregate the positions in those two $1 billion mutual funds because they follow "substantially identical trading strategies." To provide another example, under the proposed SITS Rule, a $10,000 investor in a fund-of-funds that, in turn, invests $10,000 in two $1 billion commodity index funds that follow "substantially identical trading strategies" would have to aggregate the positions in those two $1 billion funds – even if the investor did not know how the fund-of-funds manager allocated the investor's money. (In contrast, under proposed 150.4(b)(1)'s exemption for investors in commodity pools, it appears that if an investor made a $500 million investment in a single $1 billion commodity index pool, it would be exempt from speculative position limits altogether).

To comply with the aggregation requirement of the proposed SITS Rule, the investor in the foregoing scenarios would not only have to determine how his or her funds are being invested, but also the trading strategies of all of the relevant funds and whether they meet the undefined test of being "substantially identical." Then, he or she would need a data feed to determine the size of the commodity derivatives positions in each fund determined to be using a "substantially identical trading strategy." Such a requirement would simply be unworkable in most cases (depending on, among other things, the size of the investment, the size of the funds with "substantially identical trading strategies" that the investor's money has been invested in, and the investor's other countable commodity derivatives positions). Even if it could be done (the practical impediments described above aside, there would also be significant and costly legal and operational obstacles to overcome), to implement such a compliance program to prevent inadvertent violations of speculative position limits due to the aggregation requirement of the proposed SITS Rule, would cost many times the investor's $10,000 investments.

[41] 76 Fed. Reg. at 71,654.

[42] The 2011 rulemaking was not very clear when it adopted an aggregation requirement for investments in accounts or pools with "identical trading strategies." Now, the 2013 Aggregation NPRM provides no guidance as to the meaning of "substantially identical trading strategies," nor does it explain how the concern about circumvention has changed from 2011 to 2013 that would explain the difference between "identical" and "substantially identical."

4. Independent Account Controller Exemption

We commend the Commission's inclusion of an IAC exemption that allows asset management companies to disaggregate the positions of customer accounts controlled by an IAC. We also commend the Commission for proposing to allow managers of employee benefit plans in proposed 150.4(b)(5) to qualify as IACs. We do have concerns, however, with two aspects of the proposed IAC exemption, described below.

4.1. The definition of IAC[43] should not be limited based upon CPO or CTA status.

The status of entities as registered, exempt or excluded CPOs or CTAs has nothing to do with the purpose behind the IAC: to provide for a safe harbor from aggregation requirements where there is no shared ownership or control between a parent advisor and sub-advisors. The Commission has not articulated a reason why IAC status should be limited to certain registrants on the one hand and certain exempt or excluded entities on the other. All pool operators and trading advisors should be able to avail themselves of the IAC exemption, irrespective of their status as registered, exempt or excluded.

4.2. The proposed IAC notice filing should not be required.

We question the utility of requiring asset managers to submit notice filings complying with proposed 150.4(c)(1) to claim the proposed 150.4(b)(5) IAC exemption. Under the Commission's current IAC exemption (17 CFR 150.3(e)), no such filing is required. The new proposed filing is unduly burdensome, particularly given the fact that we are aware of no abuses of the existing IAC exemption. In lieu of a notice filing, the Commission should consider a requirement to keep records on the eligible entity's and IAC's compliance with the conditions of the IAC exemption. If, however, the Commission requires a filing, it should allow for a simplified generic, omnibus filing that would provide the Commission notice that an eligible entity intends to use the exemption on a going-forward basis consistent with the terms of the exemption.

5. Summary

For the reasons stated above, we recommend that the Commission make the following changes in any final rulemaking adopting the 2013 Aggregation NPRM:

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[43] Proposed 150.1 defines "independent account controller" to mean a person (1) who specifically is authorized by an eligible entity, independently to control trading decisions on behalf of, but without the day-to-day direction of, the eligible entity; (2) over whose trading the eligible entity maintains only such minimum control as is consistent with its fiduciary responsibilities for managed positions and accounts to fulfill its duty to supervise diligently the trading done on its behalf or as is consistent with such other legal rights or obligations that may be incumbent upon the eligible entry to fulfill; (3) who trades independently of the eligible entity and of any other IAC trading for the eligible entity; (4) who has no knowledge of trading decisions by any other IAC; and (5) who is (i) registered as an FCM, an introducing broker, a CTA, or an associated person of any such registrant, or (ii) a general partner, managing member or manager of a commodity pool the operator of which is excluded from registration under Rule 4.5 or 4.13.

- The Commission should not adopt the proposed owned entity aggregation as proposed. Instead, the rules should be amended as discussed above in order to address the impact on passive investors that have no control over, or even knowledge of, the specific commodity derivatives trading activities of owned entities in which they have invested.

- The Commission should amend 150.4(b)(1)(iii) to only require passive investors to aggregate positions of a Commission regulation 4.13 exempt pool based on a 25% or more ownership interest when "the operator of which is exempt from registration *under §§ 4.13(a)(1) or (a)(2)*."

- The Commission should omit the requirement to aggregate investments in funds that follow "substantially identical trading strategies" from any final rulemaking.

- The Commission should expand the scope of entities eligible to become IACs, so no distinction is made based upon CPO or CTA registration, exemption or exclusion status. In addition, the IAC notice filing requirements should be eliminated.

* * *

We appreciate your consideration of our comments. We stand ready to provide any additional information or assistance that the Commission might find useful. Should you have any questions, please do not hesitate to contact Matt Nevins at 212-313-1176 or Michael Loesch at 202-662-4552.

Sincerely,

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Enclosure 2

asset management group

August 1, 2014

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

Re: Notice of Proposed Rulemaking – Aggregation of Positions (RIN 3038-AD82)

The Asset Management Group ("AMG")[1] of the Securities Industry and Financial Markets Association ("SIFMA") appreciates the opportunity to provide the Commodity Futures Trading Commission (the "Commission") with supplemental comments regarding the "Aggregation of Positions" proposed rulemaking ("2013 Aggregation NPRM").[2] As asset managers, AMG members have a significant interest and unique perspective in the Commission's proposed aggregation requirements for purposes of applying speculative position limit rules. We appreciate the opportunity to have participated in the Aggregation Panel at the staff's public Roundtable on position limits for physical commodity derivatives held on June 19, 2014 (the "Roundtable").

We are writing this supplemental comment letter to provide further detail on some of the questions that were raised during the Aggregation Panel of the Roundtable[3] and to recap briefly the main concerns expressed by AMG during the Roundtable and in our initial comment letter on the 2013 Aggregation NPRM.[4]

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[1] The AMG's members represent U.S. asset management firms whose combined assets under management exceed $30 trillion. The clients of AMG member firms include, among others, registered investment companies, ERISA plans, and state and local government pension funds, many of whom invest in commodity futures, options, and swaps as part of their respective investment strategies.

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

[3] At the Roundtable, questions were asked of the Aggregation Panel as to: 1) how to reconcile the notion of basing position aggregation on control of trading rather than ownership with the relevant statutory text; and 2) how other regulations that use ownership as an indicia of control are distinguishable from position limits aggregation. We address both these questions in this letter.

[4] A copy of AMG's initial comment letter on the 2013 Aggregation NPRM, filed on February 10, 2014 ("Initial Aggregation Letter"), is enclosed for convenience.

1. Owned Entity Aggregation Should Only Apply Where There is Trading Control

1.1. Interest of Asset Managers in the Proposed Owned Entity Aggregation Rules.

Asset managers often put on commodity derivative positions directly for the funds and accounts that they manage. Asset managers also acquire equity interests in operating companies for the funds and accounts that they manage. Those operating companies also may use commodity derivatives, but the fund or account investing in the equity of the operating company, and its asset manager, typically will not have control over the commodity derivatives positions held by the operating company. While asset management companies would not generally need to aggregate customer positions managed by independent account controllers under the independent account controller ("IAC") exemption, it alone is not sufficient to assuage the concerns of AMG members with respect to the 2013 Aggregation NPRM, particularly with regard to its owned entity provisions. Individual asset managers may find it difficult to avail themselves of the IAC exemption for commodity derivatives positions held by owned entities where a fund or account that it manages has beneficial equity ownership of 10% or more. Accordingly, the owned entity aggregation requirement (and its exemptions) are vitally important to AMG members.

AMG firmly believes that aggregation should not be mandated where an asset manager, or the fund or account that it manages, is a passive investor and does not have trading control over the commodity derivatives positions of the underlying operating company in which the fund or account invests. During the Roundtable, several panelists echoed that point.

1.2. Aggregation Based on Ownership Rather than Control Is Not Required or Authorized by the CEA.

The owned entity aggregation requirement in the 2013 Aggregation NPRM is based on the view that the language of Section 4a of the CEA "requires aggregation on the basis of *either ownership or control of an entity*."[5] More specifically, the 2013 Aggregation NPRM reads the "ownership clause" of CEA Section 4a(a)(1) to permit ownership of another entity, standing alone, to serve as a separate and distinct basis to require aggregation of positions held by that owned entity, regardless of actual control of such trading accounts.[6]

As discussed in AMG's Initial Aggregation Letter, however, a close reading of the statutory text reveals that aggregation must be based on control (and not ownership alone).[7]

[5] 78 Fed. Reg. at 68,956 (emphasis added).

[6] *Id., citing* 77 Fed. Reg. at 31,773.

[7] We note that the revised staff questions posted on the Commission's website in connection with the Roundtable stated that "Section 4a(a)(1) of the CEA requires aggregation of an entity's positions on the basis of either ownership or control of the entity . . .". *See Position Limits Roundtable: Revised Staff Questions* at 6 n.9, available at http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/staffquestions061214.pdf. For the reasons discussed in text, we believe that this statement is not consistent with the correct reading of the statutory text.

Consequently, we believe that the proposed owned entity aggregation requirement of the 2013 Aggregation NPRM would exceed the Commission's authority under the CEA.[8]

The relevant portion of CEA Section 4a(a)(1) reads as follows:

> [T]he positions held and trading done by *any persons directly or indirectly controlled by such person* shall be included with the positions held and trading done by such person. . .[9]

In the first clause quoted above, the phrase "any persons" refers to third parties, whereas the phrase "such person" refers to the "investor" subject to this statutory aggregation provision. In other words, the positions held and trading done by a third party (*i.e.,* the controlled entity) which are directly or indirectly controlled by the investor shall be included with the positions held and trading done by the investor. The second clause quoted above, which is the "ownership clause" relied on by the 2013 Aggregation NPRM and which reads "positions held and trading done by such person" (*e.g.,* the investor), actually applies to positions "held" (*i.e.,* owned) and trading done (*i.e.,* performed) by the investor (and not to positions held by the controlled entity).

On its face, CEA Section 4a(a)(1), requires aggregation of positions held and trading done by third parties only when the third party's positions and trading are "*directly or indirectly controlled*." The statute specifically addresses the conditions under which a third party's positions are to be aggregated. CEA Section 4a(a)(1) does not provide for aggregation when the positions are held by a third party that is owned, but not controlled, or leave open room for inferring an "ownership aggregation" requirement by the Commission.[10]

In sum, the Commission should eliminate the owned entity aggregation requirement from any final rule as it is not authorized by the statute. By doing so, the Commission would: 1) properly limit aggregation of an owned entity's positions to the situation provided for in CEA Section 4a(a)(1), namely, where there is control of those positions; and 2) properly limit the ownership clause of CEA Section 4a(a)(1) to positions owned by the investor, not an owned entity.

1.3 Positions Held by an Owned Operating Company are Distinguishable from Positions Held in an Owned Trading Account.

Aggregation of positions held by an operating company in which an entity invests should not be required where that entity does not have actual trading control over the commodity derivatives positions held or trading done by such operating company. For example, in the asset

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[8] *See* AMG Initial Aggregation Letter at 7-8.

[9] 7 U.S.C. 6a(a)(1) (emphasis added).

[10] The legislative history of the CEA is consistent with this point. A 1968 Senate Report provides that "Section 2 of the bill amends section 4a(1) of the [CEA] to show clearly the authority to impose limits on […] trading done and positions held by a person controlled by another shall be considered as done or held by" a person (e.g., the investor). S. Rep No. 947, 90th Cong., 2 Sess. 5 (1968).

management context, commodity derivatives positions held and controlled by an operating company in which an investment fund or institutional account invests should not be aggregated with the positions controlled by the fund or account or its asset manager.

The Commission historically has interpreted "accounts" for aggregation purposes to encompass accounts owned by third parties that are commonly owned, but not commonly controlled.[11] All of the Commission's pre-2011 position aggregation rulemakings required aggregation on the basis of direct ownership in accounts, not ownership interests in third parties that, in turn, own positions in derivatives trading accounts.[12]

We believe that it is worth reiterating the practical difficulties that would be imposed on asset managers if they were required to aggregate positions held by operating companies in which the funds or accounts that they manage invest. Asset managers would need to monitor the equity ownership held by the funds and accounts that they manage for this purpose, and would need to develop some system of monitoring commodity derivatives positions held by these operating companies. Moreover, operating companies may not be willing to divulge their commodity derivatives positions to asset managers of funds or accounts that invest in these entities, and even if they would be willing, the information may not be made available on a timely basis. These challenges alone render aggregation on the basis of equity ownership in operating companies an unworkable policy.

1.4. Unlike Other, Unrelated Regulations, Ownership is Not an Appropriate Indicia of Control for Purposes of Aggregation of Commodity Derivatives Positions.

The appropriateness of basing an agency rule on an ownership threshold depends on the purpose of the particular rule at issue.[13] With respect to certain rules, including antitrust, securities, and Federal Energy and Regulatory Commission ("FERC") rules, equity ownership is relevant to rules that relate to corporate control. Conversely, equity ownership is not an appropriate indicia of control for purposes of requiring aggregation of commodity derivatives positions for speculative position limits; rules adopted in the context of corporate control are of

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[11] *See, e.g.,* the Commission's 1979 Statement of Aggregation Policy, which is squarely focused on ownership of accounts, not ownership in entities that own accounts. Its first point stated that "[e]xcept for a limited partner or shareholder (other than a commodity pool operator) in a commodity pool, any person who has a 10 percent or more financial interest in an account will be considered as an account owner." Statement of Policy on Aggregation of Accounts and Adoption of Related Reporting Rules, 44 Fed. Reg. 33,839 (Jun. 13, 1979).

[12] AMG's Initial Aggregation Letter detailed how the owned entity aggregation requirement in the 2013 Aggregation NPRM also is inconsistent with: 1) the legislative history of CEA Section 4a; 2) the Commission's historical approach to aggregation for position limit purposes; 3) other Commission rules; and 4) even the Commission's enforcement history. *See* AMG Initial Aggregation Letter at 8-11.

[13] The Commission and the Securities and Exchange Commission ("SEC") made this point in their joint "Entity Definitions Rulemaking." *See Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant,"* 77 Fed. Reg. 30,596 (May 23, 2012).

limited relevance for this purpose. As discussed above, the statutory text of CEA Section 4a(a)(1) is consistent with this view as it authorizes aggregation only where an investor *controls the trading* that occurs in an owned entity's accounts.[14]

By contrast, for example, the antitrust provisions cited in the 2013 Aggregation NPRM address when companies must file a pre-merger notification with federal regulators under the Hart–Scott–Rodino Antitrust Improvements Act. This requirement seems logical given that equity ownership is indicative of control with respect to acquisitions and size of the market. The SEC uses ownership percentages for various purposes, including requiring disclosures of information, reporting and determining the existence of restricted or control securities, but not for limiting speculative trading activity with respect to derivatives or securities within its jurisdiction. FERC's rules regulating public utility holding companies and electric power market participants address size of the market and not the type of concerns about controlling trading activity at issue in the CFTC's aggregation rulemaking.

The purpose of the Commission's aggregation rules is to help prevent coordinated trading that could yield the type of excessive speculation or manipulative activity that position limits are designed to address. Passive investors of the type managed by AMG members – even where their ownership interest exceeds 50% – simply do not have control over the commodity derivatives trading decisions of owned operating companies that would raise the specter of coordinated trading activity.[15] Conflating equity ownership with trading control in these circumstances would be misguided.[16]

2. Recap of Other Key Points from AMG's Initial Comment Letter

In addition to our views on owned entity aggregation expressed above, we would like to reiterate the following fundamental points that were expressed in further detail in our Initial Aggregation Letter and at the Roundtable:

[14] *See also* AMG's Initial Aggregation Letter at 11-12 (detailing how the Commission traditionally has interpreted "control" in CEA Section 4a(a)(1) and its predecessors as control of trading, not corporate control).

[15] Under some circumstances, when a passive investor (for example, an ERISA plan) makes an investment in an entity, the investor's fiduciary duties (for example, as created under ERISA) could entail making prudent inquiries into the trading activities and investments of the owned entity. *See Harley v. Minnesota, Mining and Manufacturing Co*., 898 F. Supp. 2d 898, 906 (D. Minn. 1999) ('[A] fiduciary is required to undertake an independent investigation into the merits of an investment and to use appropriate, prudent methods in conducting the investigation."), *aff'd,* 284 F.3d 901 (8th Cir. 2002), *cert. denied,* 537 U.S. 1106 (2003); 29 CFR 2550.404a-1(b)(2) (providing that an investment fiduciary, when evaluating an investment, must take into consideration the risk of loss associated with the investment). This fiduciary duty to prudently inquire falls far short of coordinated trading activity.

[16] During the Aggregation Panel at the Roundtable, representatives of both CME Group and ICE explained that they use ownership as an indicia of control in performing their market surveillance function. This may be appropriate. But the use of ownership by market surveillance staff of an exchange (or the Commission) to identify situations warranting closer review, in order to determine whether coordinated trading in fact may be taking place, is far different than *requiring* aggregation of positions of owned entities, based solely on ownership of that entity, in determining whether a trader has exceeded speculative position limits.

- ***Aggregation of Investments in Accounts or Pools with "Substantially Identical Trading Strategies" Should Not be Required, Particularly where there is an Independent Account Controller***. The Commission should not adopt the requirement in proposed rule 150.4(a)(2) to aggregate investments in funds that follow "substantially identical trading strategies" regardless of common trading control, significant ownership, or even knowledge of the relevant investments. This is particularly the case in situations where the accounts or pools with "substantially identical trading strategies" have independent account controllers; where independent entities control the trading for these strategies, these positions should not be aggregated. Any contrary result would have a disparate, unjustified effect on fund-of-fund managers that invest in multiple funds employing the same or similar commodity strategy, even if the positions in those funds are controlled by independent fund managers. Further, this could run counter to other regulatory requirements, such as those applicable to investment companies registered with the SEC.[17] (See AMG's Initial Aggregation Letter at pps. 13-14.)

- ***The Independent Account Controller Exemption Should Not be Limited by CPO/CTA Registration Status*.** The Commission should extend "independent account controller" eligibility to registered commodity pool operators ("CPOs"), exempt and excluded CPOs, and exempt and excluded commodity trading advisors ("CTAs"). In addition, the burdensome requirement on asset managers to submit notice filings to claim the independent account controller exemption should be eliminated. (See AMG's Initial Aggregation Letter at p. 15.)

- ***Any Procedures Adopted to Perfect Exemptions Should be Simplified***. While we strongly believe that the Commission should forgo an owned entity aggregation requirement in any final rulemaking, if the Commission proceeds with such a requirement, we believe that the exemptions proposed in the 2013 Aggregation NPRM should be substantially liberalized. Specifically, we believe that any proposed requirements that investors ensure that the entities in which they invest maintain written procedures, that financials are not consolidated, or that directors make certifications should be eliminated. Similarly, we recommend eliminating any notice filing requirements for the owned entity exemption, or at the very least, allowing use of a simplified, generic omnibus filing.[18] (See AMG's Initial Aggregation Letter at pps. 4-7, 15).

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[17] *See, e.g.,* Section 12(d)(A)(1) of the Investment Company Act of 1940 and the rules promulgated thereunder, which impose limits on the amount of investments that a registered investment fund may make in any other registered investment company; this requirement could cause a registered fund-of-funds to invest in multiple funds with substantially identical trading strategies.

[18] This recommendation with respect to filing requirements applies to both an owned entity aggregation exemption, to the extent owned entity aggregation remains part of any final rule, and the independent account controller exemption.

- ***Passive Investors in Rule 4.13 Exempt Pool Aggregation Requirement.*** The Commission should revise proposed rule 150.4(b)(1)(iii) to require passive investors to aggregate positions of a Rule 4.13 exempt pool based on a 25% or more ownership interest only when "the operator of which is exempt from registration *under §§ 4.13(a)(1) or (a)(2).*" This revision is appropriate in order for the requirement to apply to its intended targets. (See AMG's Initial Aggregation Letter at p. 13.)

3. Summary

For the reasons stated above, AMG recommends that the Commission not adopt the proposed owned entity aggregation rules as proposed in the 2013 Aggregation NPRM. Instead, the rules should be revised as discussed above in order to address their impact on passive investors that have no control over, or even knowledge of, the specific commodity derivatives trading activities of owned entities in which they have invested.

*   *   *

We appreciate your consideration of our comments. We stand ready to provide any additional information or assistance that the Commission might find useful. Should you have any questions, please do not hesitate to contact Matt Nevins at 212-313-1176 or Terry Arbit at Norton Rose Fulbright at 202-662-0223.

Sincerely,

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Enclosures: AMG Initial Comment Letter Regarding Notice of Proposed Rulemaking – Aggregation of Positions (RIN 3038-AD82)

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February 10, 2014
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Re: Notice of Proposed Rulemaking – Aggregation of Positions (RIN 3038-AD82)

The Asset Management Group ("AMG")[1] of the Securities Industry and Financial Markets Association ("SIFMA") appreciates the opportunity to provide the Commodity Futures Trading Commission (the "Commission") with comments regarding the "Aggregation of Positions" proposed rulemaking ("2013 Aggregation NPRM").[2] We believe that the Commission has made some positive steps in this 2013 Aggregation NPRM, but we have some significant concerns with respect to certain aspects of the proposal, in the following areas in particular:

- ***Owned Entity Aggregation.*** The Commission should not adopt the owned entity aggregation as proposed. Requiring passive investors, which include, without limitation, registered and private commodity pools and other investment vehicles, pension funds and other institutional clients of asset managers, that have no control over, or even knowledge of, the specific commodity derivatives trading activities of owned entities they have invested in to aggregate the positions of such entities would impose significant costs that would unnecessarily diminish their ability to provide valuable capital investment and generate returns for their beneficiaries and participants, exceeds the scope of the Commission's position aggregation authority under the Commodity Exchange Act ("CEA"), and is an unwarranted departure from the Commission's historical aggregation approach. The proposed exemptions from this owned entity aggregation requirement under proposed rules 150.4(b)(2) (10 to 50% ownership) and (b)(3) (above 50% ownership) do not sufficiently address the flaws of the proposed approach to aggregating owned entity positions in the passive investment ownership context.

[1] The AMG's members represent U.S. asset management firms whose combined assets under management exceed $20 trillion. The clients of AMG member firms include, among others, registered investment companies, ERISA plans, and state and local government pension funds, many of whom invest in commodity futures, options, and swaps as part of their respective investment strategies.

[2] 78 Fed. Reg. 68,946 (Nov. 15, 2013).

- ***Investment in Accounts or Pools with "Substantially Identical Trading Strategies."*** The Commission should not adopt the aggregation requirement in proposed 150.4(a)(2) for investments in funds that follow "substantially identical trading strategies" regardless of common trading control, significant ownership, or even knowledge of the relevant investments. This proposal is vague and lacks sufficient statutory, policy, and cost-benefit rationale.

- ***Passive Investors in Commission Regulation 4.13 Exempt Pool Aggregation Requirement.*** We recommend that the Commission amend 150.4(b)(1)(iii) to only require passive investors to aggregate positions of a Commission regulation 4.13 exempt pool based on a 25% or more ownership interest when "the operator of which is exempt from registration *under §§ 4.13(a)(1) or (a)(2)*" in order for this requirement to apply to its intended targets.

- ***Independent Account Controller Exemption.*** We recommend that the Commission extend "independent account controller" eligibility to registered commodity pool operators ("CPOs"), exempt CPOs, and exempt and excluded commodity trading advisors ("CTAs"). We also question the utility of the burdensome requirement on asset managers to submit notice filings to claim the independent account controller exemption.

1. Owned Entity Aggregation

Consistent with current 17 CFR 150.4(a), under proposed 150.4(a)(1), a person would be required to aggregate "positions in accounts" in which the person "directly or indirectly" has more than a 10% ownership interest. The Commission further proposes to interpret "accounts or positions" to include "accounts or positions" of third party[3] owned entities.[4] The Commission interprets ownership of another entity, standing alone, as providing a separate and distinct basis to require aggregation of the positions owned by the owned entity, regardless of actual control of such trading accounts.[5] That is, the Commission interprets the "ownership prong" of CEA section 4a(a)(1) to apply to accounts owned by owned entities if a person has an ownership interest greater than 10% in that owned entity (and otherwise does not have trading control or have a direct ownership interest in the owned entity accounts themselves).[6]

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[3] We use the term "third party" to refer to any person that is separate from another person. A person can have relationships with many types of third parties, e.g., an owned entity, an entity it does not have an ownership interest in but whose trading it controls, etc.

[4] *See* proposed 150.4(b)(2) (providing for an exemption from aggregation requirements for positions in accounts of an owned entity when the ownership interest in the owned entity is between 10 and 50% of total equity). *See also* 78 Fed. Reg. at 68,959.

[5] *Id.* citing 77 Fed. Reg. at 31,773.

[6] *Id.* ("The Commission continues to believe, as stated in the Part 151 Aggregation Proposal, that an equity or ownership interest above 50% constitutes a majority ownership or equity interest of the owned entity and is so significant as to justify aggregation under the ownership prong of Section 4a(a)(1) of the CEA.")

For the reasons set forth below, we recommend that the Commission reconsider its proposed owned entity aggregation rules. We present our specific recommendations in section 1.3 below.

1.1. Requiring passive investors that have no control over, or even knowledge of, the specific commodity derivatives trading activities of owned entities to aggregate the positions of such entities will be unduly costly.

While asset management companies would not generally need to aggregate customer positions managed by independent account controllers under proposed 150.4(b)(5)'s independent account controller ("IAC") exemption, individual IAC or non-IAC asset managers often invest customer assets (either directly or through investment vehicles) in entities that trade in commodity derivatives. Under the Commission's proposed 150.4(a), 10% or more ownership in a trading account may be sufficient to warrant aggregation. In this case, under the Commission's interpretation of the term "account,"[7] a purely passive holder of equity securities would be required to aggregate the positions of all entities of which it has beneficial equity ownership of 10% or more, unless it perfects an exemption to owned entity aggregation (most pertinently under proposed 150.4(b)(2) or (b)(3)). An arbitrary owned entity aggregation threshold at 10% ownership is vastly over-inclusive even if it is used as indicia of corporate control;[8] the Commission itself points out that corporate "control" is imputed at 50% or more ownership for the purpose of pre-merger notifications to federal regulators under the Hart–Scott–Rodino Antitrust Improvements Act.[9]

Passive investors of the type managed by AMG members do not have control over owned entities by virtue of their *passive* ownership interest in a legal entity. As such, they would typically only have minimal knowledge of these owned entities' trading positions and decisions.[10] The 2013 Aggregation NPRM would create a new standard of care for passive investors: they would have to determine whether and to what extent the owned entity (and all of its owned entity affiliates) trade in commodity derivatives and if so, act to perfect an exemption. If no exemption is available, then the passive investor would have to obtain reliable commodity

[7] We believe this reading would constitute an unexplained change from Commission administrative precedent. *See* section 1.4 below.

[8] As discussed below in section 1.7, the appropriate control standard under Commission position limits rules relates to trading control, not corporate control.

[9] 78 Fed. Reg. at 68,958, *citing* 16 CFR 801.1(b).

[10] Under some circumstances, when a passive investor (for example an Employee Retirement Income Security Act ("ERISA") plan) makes an investment in an entity, the investor's fiduciary duties (for example, as created under ERISA) could very well entail making prudent inquiries into the trading activities and investments of the owned entity. *See Harley v. Minnesota, Mining and Manufacturing Co*., 898 F. Supp. 2d 898, 906 (D. Minn. 1999) ('[A] fiduciary is required to undertake an independent investigation into the merits of an investment and to use appropriate, prudent methods in conducting the investigation."), *aff'd,* 284 F.3d 901 (8th Cir. 2002), *cert. denied,* 537 U.S. 1106 (2003); 29 CFR § 2550.404a-1(b)(2) (providing that an investment fiduciary, when evaluating an investment, must take into consideration the risk of loss associated with the investment).

derivatives position information from the entities in which it invests and is required to aggregate in order to ensure compliance with speculative position limits. In addition, these passive investors would have to develop, often from scratch, costly position monitoring infrastructure and hire or train staff to apply that infrastructure to the derivatives positions of their investments in order to ensure compliance with position limits. These costs to passive investors would deter investment in businesses that own commodity positions and are not offset by any commensurate benefit, especially in terms of reduced likelihood of excessive speculation or manipulation.

1.2. The proposed owned entity aggregation exemptions provide inadequate relief for passive investors and do nothing to further the goals Congress directed the Commission to achieve in promulgating position limits.

The Commission proposes two exemptions to the proposed general rule that requires a person to aggregate accounts owned by a third-party entity where such person has a greater than 10% ownership in the owned entity:

1. Under proposed 150.4(b)(2), the Commission proposes an aggregation exemption for ownership interests of up to 50% of an entity's equity under certain conditions. The owner and the owned entity ("Related Entities") must not have knowledge of one another's trading decisions and have in place protections to ensure independence, including: (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 before a trade is made. This exemption is effective upon submission of a notice filing under proposed 150.4(c)(1).

2. Under proposed 150.4(b)(3), the Commission proposes an aggregation exemption for ownership interests above 50% ownership under certain conditions. These conditions include all of those described above for ownership interests at and below 50% ownership, plus: (1) certification that the Related Entities' financial results are not consolidated in a financial statement pursuant to relevant accounting rules; (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. This exemption must be approved by the Commission or staff operating under delegated authority in order to become effective under proposed 150.4(c)(2).

These two exemptions would provide inadequate relief for passive investors and would do nothing to further the goals Congress directed the Commission to achieve in promulgating position limits.

First, while a move in the right direction, the proposed 150.4(b)(2) exemption from aggregation for ownership interests of up to 50% in the owned entity does not extend to all ownership interests and would require a burdensome notice filing in all investment circumstances, regardless of the absence of common trading control, for no apparent benefit. By

contrast, passive investors in a pool that are not affiliated with the pool operator under proposed 150.4(b)(1) would not be required to submit a notice filing to disaggregate the positions of pools in which they have invested, regardless of their ownership interest in the pool. Again, the 2013 Aggregation NPRM provides no reason why passive investors in owned entities should not have at least the same degree of deference.

Second, the proposed application-based exemption from aggregation in 150.4(b)(3) for ownership interests in excess of 50% is, as a practical matter, unworkable. Passive investors cannot plan their investment and compliance programs around a disaggregation application filing that depends on Commission approval which, even if granted, may take weeks or months to issue, while their managers may need to make immediate investment decisions.

Moreover, the conditions imposed on the proposed 150.4(b)(3) exemption seriously constrain its utility. This is particularly true of the condition prohibiting consolidation of financial results. The fact that an investor consolidates the financial results of the firms in which it invests is not indicative of trading control; earning returns on an investment is the main reason an investor invests. In addition, the requirement that the owned entity's positions not exceed 20% of any position limit effectively subjects owned entities to lower position limits.[11] The 2013 Aggregation NPRM makes no findings that this restriction furthers any of the goals Congress directed the Commission to achieve in promulgating position limits rules under CEA sections 4a(a)(2)(C) and 4a(a)(3)(B).

1.3. The Commission should reconsider its owned entity aggregation requirements.

For reasons stated in more detail in section 1.4 below, we believe the Commission's proposed owned entity aggregation requirements are legally flawed and based on an erroneous interpretation of the CEA and applicable administrative precedent. We recommend, therefore, that the Commission re-examine the 2013 Aggregation NPRM and substantially amend the proposed 150.4(b)(2) and (3) exemptions to achieve a more appropriate balance among the six statutory factors that the CEA requires the Commission to address when promulgating any position limit rules,[12] by:

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[11] The alternative requirement that all of the owned entity's positions be bona fide hedging positions is not an independent condition. CEA section 4a(c)(1) prohibits the Commission from restricting the bona fide hedging positions of any trader: "No rule, regulation, or order issued under subsection (a) of this section shall apply to transactions or positions which are shown to be bona fide hedging transactions[.]" CEA section 4a(c)(1). Therefore, the limitation that an owned entity's positions be limited entirely to bona fide hedging positions is simply a sub-set of the requirement that would restrict speculative positions up to 20% of any limit.

[12] These factors include the "goals" stated in CEA section 4a(a)(2)(C), i.e., "striv[ing] to ensure" that (Factor 1) "trading on foreign boards of trade in the same commodity will be subject to comparable limits" and (Factor 2) "that any limits to be imposed by the Commission will not cause price discovery in the commodity to shift to trading [to FBOTs]." They also include the four additional factors that CEA section 4a(a)(3)(B) directs the Commission to balance when exercising its CEA section 4a(a)(2) authority: (1) (Factor 3) to diminish, eliminate, or prevent excessive speculation causing sudden or unreasonable fluctuations or unwarranted changes in price; (2) (Factor 4) to deter and prevent market manipulation, squeezes, and corners; (3) (Factor 5) to ensure sufficient market liquidity for bona fide hedgers; and (4) (Factor 6) to ensure that the price discovery function of the underlying market is not disrupted.

1. Extending the relief provided to passive investors in commodity pools under current 150.4(c) and proposed 150.4(b)(1) to passive investors in owned entities that do not have actual trading control of the owned entity's derivatives trading; and

2. Extending the owned entity exemption at proposed 150.4(b)(2) to include all third party ownership interests (greater than 50%) that do not involve actual common trading control.

In addition, we recommend three additional, non-exclusive changes that would reduce the cost to comply without forgoing meaningful regulatory benefit under the six statutory factors referenced above:

Filing requirements: The Commission should only require a 150.4(c)(1) notice filing when there is majority ownership in addition to indicia of trading control, e.g., a common business purpose relating to derivatives trading or the commercial use of commodities. The Commission's proposed 150.4(c)(2) application procedure should be omitted altogether or reserved for instances where there is majority ownership in addition to a trading control. In any event, a passive investor that holds an equity investment of any amount in an operating company that it has no trading control over should not be required to make any type of filing. If the Commission insists on a filing requirement for passive investors, then it should allow for a simplified, generic omnibus filing that would provide the Commission with notice that a passive investor intends to use the exemption on a going-forward basis consistent with the terms of the exemption for its passive equity investments.

Pro rata attribution of positions: The Commission should allow for the *pro rata* attribution of positions based on ownership interest. *Pro rata* allocation of positions would be less costly for passive investors because it would provide them some proportionate degree of protection if their owned entity exceeds a position limit. For example, for a passive investor with a 15% ownership interest in an owned entity that exceeds a position limit, an allocation of 15% or even 25% of that owned entity's positions would reduce the risk of an inadvertent position limits overage. Accordingly, we recommend *pro rata* allocation of ownership interests within set bands of ownership percentages.

Quarterly measurement: The costs of complying with the Commission's proposed aggregation rules would also be reduced if the Commission provided a safe harbor to passive investors to measure ownership interests on a predetermined basis, such as on quarterly dates. Permitting passive investors to measure ownership interests on a fixed and workable schedule will not undermine the Commission's position limits regime. This approach would mitigate our members' concerns about disruptions to their clients' investments that could otherwise result from frequent changes in ownership interests.

These recommendations would present substantially reduced costs for AMG members and their clients yet would still ensure at least the same degree of efficacy of the Commission's position limits regime under the goals provided by Congress in CEA sections 4a(a)(2)(C) and 4a(a)(3)(B) by providing passive investors with legal certainty that would promote liquidity in

commodity derivatives. In fact, the Commission's proposal would increase the potential for coordinated manipulative trading activity because it mandates common trading control where none currently exists.

1.4. Requiring passive investors that have no control over, or knowledge of, the specific commodity derivatives trading activities of owned entities they have invested in to aggregate the positions of such entities has not been justified.

1.4.1. Requiring passive investors that have no control over, or knowledge of, the specific commodity derivatives trading activities of owned entities they have invested in to aggregate the positions of such entities exceeds the scope of the Commission's position aggregation authority under the CEA.

The 2013 Aggregation NPRM states its basis for requiring the aggregation of owned entity positions regardless of the existence of common trading control as follows (emphasis added):

> In light of the language in section 4a, its legislative history, subsequent regulatory developments, and the Commission's historical practices in this regard, the Commission continues to believe that section 4a requires aggregation on the basis of *either ownership or control of an entity*.[13]

The relevant portion of CEA section 4a(a)(1) provides (emphasis added):

> [T]he positions held and trading done by *any persons directly or indirectly controlled by such person* shall be included with the positions held and trading done by such person; and further, such limits upon positions and trading shall apply to positions held by, and trading done by, two or more persons acting pursuant to an expressed or implied agreement or understanding, the same as if the positions were held by, or the trading were done by, a single person.

CEA section 4a(a)(1), by its terms, requires aggregation of positions held and trading done by third parties only when the other person is "*directly or indirectly controlled*."[14] This is not a situation where the CEA is silent about aggregating the positions of third parties (including owned entities) so that the Commission might fill the gap by inferring that the "ownership prong" applies to positions held by an owned third party; rather, the statute specifically addresses the conditions under which a third party's positions are to be aggregated, i.e., when the positions

[13] 78 Fed. Reg. at 68,956.

[14] In the first critical clause quoted above, the phrase "any person" refers to a third party, whereas the phrase "such person" refers to the principal person subject to this statutory aggregation provision. Thus, re-phrasing the clause slightly for purposes of clarification, the positions held and trading done by a third party (e.g., the company in which an investor invests) directly or indirectly controlled by a person (e.g., the investor) shall be included with the positions held and trading done by that person (e.g., the investor). By contrast, the "ownership prong" that appears immediately after this first clause applies only to directly held positions ("positions held and trading done by such person," e.g., the investor).

held and trading done by the third party are "directly or indirectly controlled." With respect to positions held and trading done by third parties, CEA section 4a(a)(1) imposes a constraint on the Commission's authority to require aggregation. CEA section 4a(a)(1) provides that the aggregation of positions held and trading done by third parties is to occur only when the positions held and trading done by the third party are "directly or indirectly controlled" ("Third Party Aggregation Constraint").

The statutory Third Party Aggregation Constraint is consistent with the legislative history of CEA section 4a. As cited in the Commission's 2012 "Aggregation, Position Limits for Futures and Swaps" proposed rulemaking,[15] a 1968 Senate Report provides that "Section 2 of the bill amends section 4a(1) of the [CEA] to show clearly the authority to impose limits on […] trading done and positions held by *a person controlled by another* shall be considered as done or held by" a person (e.g., the investor).[16]

1.4.2. Requiring passive investors that have no control over, or knowledge of, the specific commodity derivatives trading activities of owned entities they have invested in to aggregate the positions of such entities is an unwarranted departure from the Commission's historical aggregation approach.

The Commission interprets 17 CFR 150.4(b) and proposed Commission regulation 150.4(a) as requiring the aggregation of owned entity positions.[17] The Commission, however, has never promulgated rules (that were not vacated) in which it has interpreted "accounts" to encompass accounts owned by third parties that are commonly owned but not commonly controlled. All of the Commission's pre-2011 position aggregation rulemakings required aggregation on the basis of direct ownership in accounts, not ownership interests in third parties who, in turn, own positions in derivatives trading accounts.

For example, the Commission's 1979 Statement of Aggregation Policy is squarely focused on ownership of accounts, not ownership in entities that own accounts.[18] Its first point stated that "[e]xcept for a limited partner or shareholder in a commodity pool, any person who has a 10% or more financial interest *in an account* will be considered as an account controller" (emphasis added).[19] The 1979 Statement of Aggregation Policy defines "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…"[20]

[15] 77 Fed. Reg. 31,767 (May 30, 2012).

[16] *Id.* at 31,772 at fn. 80, citing S. Rep No. 947, 90th Cong., 2 Sess. 5 (1968) (emphasis added).

[17] Proposed 150.4(a) ("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% or greater ownership or equity interest, must be aggregated with the positions held and trading done by such person.").

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

[19] *Id.* at 33,845.

[20] *Id.*

The 2013 Aggregation NPRM presents the following quote from a position limits rulemaking from 1999 in an attempt to support its interpretation that CEA section 4a(a)(1)'s "ownership prong" includes ownership of third parties' accounts: "the Commission . . . interprets the 'held or controlled' criteria [of CEA section 4a] as applying separately to ownership of positions or to control of trading decisions."[21] However, this quote does not refer to accounts of owned entities. This is not surprising as, again, this 1999 rulemaking was squarely focused on the aggregation of directly owned accounts – and not of accounts owned by an owned third party. For example, the 1999 rulemaking provided that when a person "holds or has a financial interest in or controls more than one account, all such accounts shall be considered by the futures commission merchant, clearing member or foreign broker as a single account…"[22] Thus, neither the quote nor the rulemaking from 1999 support the interpretation in the 2013 Aggregation NPRM.

Contrary to the assertion of the 2013 Aggregation NPRM, the Commission has in fact clearly distinguished between ownership of accounts, on the one hand, and ownership in third party entities that themselves own accounts, on the other. In the context of its CFTC Form 40 rules at 17 CFR 18.04(a)(8), the Commission requires the reporting of information relating to "persons… who have a financial interest of 10% or more in the [Form 40] reporting trader *or* the accounts of the reporting trader" (emphasis added). If financial interests in "accounts" encompassed financial interests in accounts of other persons, then the Commission would have had no need to separately articulate the requirement to report financial interests in the accounts of a reporting trader and the requirement to report financial interests in the reporting trader itself.

The Commission's historical definition of "account" in the position aggregation context is consistent with other Commission regulations that also similarly define the term "account." For example, 17 CFR 39.2 defines "customer account" as meaning "a clearing member account held on behalf of customers, as that term is defined in this section, and which is subject to section 4d(a) or section 4d(f) of the [CEA]" and "house account" as meaning "a clearing member account which is not subject to section 4d(a) or 4d(f) of the [CEA]." 17 CFR 1.3(vv) defines "futures account" to mean an "account that is maintained in accordance with the segregation requirements of sections 4d(a) and 4d(b) of the [CEA] and the rules thereunder." None of these regulations define an "account" as encompassing accounts of owned entities.

The one exception is the Commission's definition of "proprietary account" in 17 CFR 1.3(y),[23] which is defined explicitly to include accounts held by "business affiliates."[24] This term

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[21] 78 Fed. Reg. at 68,956, *quoting* Revision of Federal Speculative Position Limits and Associated Rules, 64 Fed. Reg. 24,038, 24,044 (May 5, 1999).

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

[23] 17 CFR 1.3(y) "*Proprietary account*. This term means a commodity futures, commodity option, or swap trading account carried on the books and records of an individual, a partnership, corporation or other type of association: (1) for one of the following persons, or (2) of which ten percent or more is owned by one of the following persons, or an aggregate of ten percent or more of which is owned by more than one of the following persons:

[...]

is cited as support for the Commission's new interpretation of the term "account" in the position limits context.[25] The term "proprietary account," however, is irrelevant to the position limits context. The term "proprietary account" is used in 17 CFR 155.3, which requires that a futures commission merchant ("FCM") give priority to executing customer orders over orders from any "proprietary account." Moreover, the fact that the term "proprietary account" is explicitly defined to include accounts held by "business affiliates" suggests that in the Commission's regulations, the term "account," standing alone, does not include accounts of owned entities but rather refers only to directly held or controlled trading accounts.

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 derivatives trading control. The import of the Commission's Order settling an administrative enforcement action in September 2010 against Vitol Inc. and one of its affiliates for false statements in connection with NYMEX position aggregation rules (which parallel Commission rules),[26] is that control was a pre-requisite in considering whether Vitol Inc. was required to aggregate the positions of its commonly-owned affiliate.[27] The recitation of facts in the Commission's Order

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> (viii) A business affiliate that, directly or indirectly is controlled by or is under common control with, such individual, partnership, corporation or association: P*rovided, however*, That an account owned by any shareholder or member of a cooperative association of producers, within the meaning of section 6a of the [CEA], which association is registered as a futures commission merchant and carries such account on its records, shall be deemed to be an account of a customer and not a proprietary account of such association, unless the shareholder or member is an officer, director or manager of the association."

[24] 17 CFR 1.3(y)(1)(viii).

[25] 78 Fed. Reg. 68,956 citing 17 CFR 1.3(y).

[26] "Ownership of Accounts – Except as set forth in Section E. below, any person holding positions in more than one account, or holding accounts or positions in which the person by power of attorney or otherwise directly or indirectly has a 10% or greater ownership or equity interest, must aggregate all such accounts or positions unless such person is a limited partner, shareholder, member of a limited liability company, beneficiary of a trust or similar type of pool participant in a commodity pool. […]." CME Rule 559.D.2, available at http://www.cmegroup.com/rulebook/CME/I/5/5.pdf. Certain commodities are currently subject only to position limit rules set by designated contract markets ("DCMs"). Aggregation for purposes of DCM-set position limits today is governed by Core Principle 5 "Position Limitations or Accountability" in CEA section 5(d)(5) and subpart F of 17 CFR part 28. CEA section 5(d)(1)(B) provides that DCMs have "reasonable discretion in establishing the manner in which the board of trade complies with the core principles described in this subsection" unless "otherwise determined by the Commission by rule or regulation." Under 17 CFR 38.301, DCMs "must meet the requirements of parts 150 and 151 of this chapter, as applicable." The only Commission regulation that relates to the aggregation of positions for exchange-set position limits (and that was not vacated) is 17 CFR 150.5(g). 17 CFR 150.5(g) provides that DCMs must aggregate on the basis of control and does not prescribe any other standard:

> In determining whether any person has exceeded the limits established under this section, all positions in accounts for which such person by power of attorney or otherwise directly or indirectly controls trading shall be included with the positions held by such person[.]

[27] 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/enfvitolorder09142010.pdf. In this matter, the Commission found that Vitol Inc. and its affiliate willfully failed to correct NYMEX's misperception of the "true nature of the relationship between" Vitol Inc. and its affiliate and imposed a civil monetary penalty of $6 million.

focused on Vitol Inc.'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 commonly owned Vitol affiliates.[28] These facts would have been relevant only if common control were a pre-condition to the application of the position aggregation rules (as it is due to the statutory Third Party Aggregation Constraint). Tellingly, no facts relating to common ownership were included in the Order.[29]

1.4.3. The 2013 Aggregation NPRM uses an inappropriate baseline in considering the costs and benefits of its proposed owned entity aggregation rules.

In its discussion of "Cost-Benefit Considerations," the 2013 Aggregation NPRM states that its proposed owned entity aggregation policy is "more permissive than the 10% [owned entity position aggregation] threshold currently provided."[30] It therefore assumes a cost-benefit baseline that requires aggregation of positions for position limit compliance purposes based solely on ownership, regardless of the existence of common control.

This is an inappropriate baseline for two important reasons. First, as described above, neither the Commission nor DCMs (which currently are the sole administrators of position limits for all but nine agricultural commodities, including 19 of the 28 "referenced contracts"), currently require the aggregation of owned entity positions regardless of the existence of common control. Therefore, the Commission's proposal is more restrictive, not "more permissive" than (and, indeed, a dramatic departure from) the existing position aggregation regime. Second, speculative positions outside of the spot month have not been subject to position limits in 19 of the 28 "referenced contract" markets the Commission proposes to subject to position limits under an accompanying release.[31] Aggregating non-spot-month positions of entities in which passive investors make investments presents considerable new challenges, which have not been adequately considered by the 2013 Aggregation NPRM.

1.4.4. "Control" in the context of position aggregation requirements means actual control of derivatives trading, not of anything else, and therefore the owned entity aggregation requirements cannot be based on a theory of corporate control.

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[28] *Id.*

[29] *See also* Order Instituting Proceedings Pursuant to Sections 6(c) and 6(d) of the Commodity Exchange Act, as Amended, Making Findings and Imposing Remedial Sanctions, at 4, http://www.cftc.gov/ucm/groups/public/@lrenforcementactions/documents/legalpleading/enfcitigroupcgmlorder092112.pdf (Sept. 21, 2012) (finding that Citigroup was liable for the position limits violation of its subsidiary Citigroup Global Markets not on the basis of owned entity aggregation requirements under 17 CFR 150.4(b), but rather on the basis of an agency theory (CEA section 2(a)(1)(B) and 17 CFR 1.2).

[30] 78 Fed. Reg. at 68,968.

[31] 78 Fed. Reg. at 75,826. AMG is commenting separately on this proposal, including proposed 150.5(a)(5) providing that aggregation requirements of exchanges must "conform to" those of the Commission under proposed 150.4.

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As noted above, the 2013 Aggregation NPRM bases its proposed owned entity aggregation rules solely on CEA section 4a(a)(1)'s "ownership prong." The 2013 Aggregation NPRM suggests in defense of the 50% ownership aggregation exemption threshold in proposed 150.4(b)(2) that an ownership interest of greater than 50% "is indicative of control" and therefore warrants aggregation of an owned entity's positions even in the absence of any actual trading control. This conclusion appears to be based on conflated notions of corporate control in other contexts with trading control in the position limits context. The Commission cites a 50% equity ownership threshold used by the Federal Trade Commission and Department of Justice as "reflect[ing] a general understanding that ownership at this level poses substantial potential for direct or indirect control over an owned entity."[32] This threshold is used by these other government agencies to identify potential instances of common corporate control for the purpose of anti-trust filing requirements, not of common derivatives trading control.[33] Speculative position limits aggregation requirements are based on whether ownership is indicative of derivatives *trading control*, not corporate control.

The Commission has traditionally interpreted "control" in CEA section 4a(a)(1) and its predecessors as control of trading, not of corporate control or any other concept of control. For example, the Commission's current IAC exemption to position aggregation requirements focuses on the controller's independent control of trading decisions and lack of knowledge of the trading decisions of any other IAC.[34] Indeed, the 2013 Aggregation NPRM appropriately models the conditions for the owned entity aggregation exemption in proposed 150.4(b)(2) on the conditions for the IAC exemption, i.e. factors that demonstrate independent trading control. Similarly, the Commission's definition of "controlled account" at 17 CFR 1.3(j) means an account for which a person "actually directs trading."[35] Perhaps most important of all, the terms of the Commission's proposal appear to focus on trading control, not corporate control. The Commission's proposed general aggregation rule (150.4) requires aggregation when a person "directly or indirectly controls *trading*."

Thus, even if the Commission were to abandon the ownership theory relied upon in the 2013 Aggregation NPRM for a control theory instead, the result is the same: the proposal provides no basis for the Commission to depart from its historical view that position aggregation is required only where actual common trading control exists, e.g., when an investor controls the derivatives trading that occurs in a an owned entity's accounts.[36]

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[32] 78 Fed. Reg. at 68,958, *citing* 16 CFR 801.1(b).

[33] *See* 16 CFR 802.2.

[34] 17 CFR 150.1(e).

[35] *See also* CFTC Form 102, available at http:// www.cftc.gov/ucm/groups/public/@forms/documents/file/cftcform102.pdf (prompting FCMs and others to identify "controlled accounts" of the same advisor exceeding "special account" activity thresholds).

[36] 78 Fed. Reg. at 68,958.

2. Passive Investment in Commission Regulation 4.13 Exempt Commodity Pools

2.1. The passive 17 CFR 4.13 exempt pool investor aggregation requirement should be omitted.

The 2013 NPRM proposes to require aggregation of positions in a 17 CFR 4.13 pool when a person holds a greater than 25% ownership interest in the pool under proposed 150.4(b)(1)(iii). This proposed rule is identical to current Commission rule 150.4(c)(2)(iii). The rationale for the current rule was that when there are "10 or fewer limited partners or when a limited partner has an ownership interest of 25% or greater, the limited partner" should be required to aggregate the positions of the pool.[37] The Commission was particularly concerned about single-investor pools when it adopted this requirement.[38] The only sub-paragraphs of current 17 CFR 4.13 that encompass the intended targets of this provision are sub-paragraphs (a)(1) and (a)(2). We therefore recommend that the Commission amend 150.4(b)(1)(iii) to apply to pools "the operator of which is exempt from registration *under §§ 4.13(a)(1) or (a)(2)*" in order for this requirement to apply to its intended targets.

3. Investment in Accounts or Pools with "Substantially Identical Trading Strategies"

Proposed 150.4(a)(2) provides that holding or controlling trading in more than one account or pool (collectively "funds") with "substantially identical trading strategies" requires aggregation ("SITS Rule"). This requirement would apply notwithstanding any other applicable aggregation exemption. In other words, the proposed SITS Rule would apply regardless of common control, significant ownership, or even knowledge of the relevant investments in funds with "substantially identical trading strategies."

The proposed SITS Rule should be omitted from any final rulemaking because it lacks sufficient rationale and is unworkable in practice, as discussed below. In the alternative, proposed 150.4(a)(2) should be amended to apply to "any person that, by power of attorney or otherwise, ~~holds or~~ directly controls the trading of positions" in a SITS account or pool.

3.1. The proposed SITS Rule lacks rationale.

The Commission does not provide a statutory or policy rationale for the proposed SITS Rule in the 2013 Aggregation NPRM or its 2012 predecessor.[39] The Commission's 2011 "Position Limits for Futures and Swaps" final rulemaking did contain a short rationale for a similar requirement for investments in funds with "identical trading strategies."[40] This provision, the Commission stated, was "intended to prevent circumvention of the aggregation requirements.

[37] 64 Fed. Reg. at 24,044.

[38] *Id.*

[39] There are, however, four mentions of the "identical trading strategies" rule in footnotes to the 2012 proposal. *See* e.g., 77 Fed. Reg. at 31,769 at fn. 14.

[40] *See* vacated 151.4(d).

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."[41] However, the 2011 rulemaking provided no historical example of any such circumvention.[42]

Finally, the 2013 Aggregation NPRM fails altogether to consider the costs and benefits of the 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.

3.2. The proposed SITS Rule is unworkable in practice.

As a consequence of the proposed SITS Rule, a $10,000 investor in two $1 billion commodity index mutual funds using the same index may have to aggregate the positions in those two $1 billion mutual funds because they follow "substantially identical trading strategies." To provide another example, under the proposed SITS Rule, a $10,000 investor in a fund-of-funds that, in turn, invests $10,000 in two $1 billion commodity index funds that follow "substantially identical trading strategies" would have to aggregate the positions in those two $1 billion funds – even if the investor did not know how the fund-of-funds manager allocated the investor's money. (In contrast, under proposed 150.4(b)(1)'s exemption for investors in commodity pools, it appears that if an investor made a $500 million investment in a single $1 billion commodity index pool, it would be exempt from speculative position limits altogether).

To comply with the aggregation requirement of the proposed SITS Rule, the investor in the foregoing scenarios would not only have to determine how his or her funds are being invested, but also the trading strategies of all of the relevant funds and whether they meet the undefined test of being "substantially identical." Then, he or she would need a data feed to determine the size of the commodity derivatives positions in each fund determined to be using a "substantially identical trading strategy." Such a requirement would simply be unworkable in most cases (depending on, among other things, the size of the investment, the size of the funds with "substantially identical trading strategies" that the investor's money has been invested in, and the investor's other countable commodity derivatives positions). Even if it could be done (the practical impediments described above aside, there would also be significant and costly legal and operational obstacles to overcome), to implement such a compliance program to prevent inadvertent violations of speculative position limits due to the aggregation requirement of the proposed SITS Rule, would cost many times the investor's $10,000 investments.

[41] 76 Fed. Reg. at 71,654.

[42] The 2011 rulemaking was not very clear when it adopted an aggregation requirement for investments in accounts or pools with "identical trading strategies." Now, the 2013 Aggregation NPRM provides no guidance as to the meaning of "substantially identical trading strategies," nor does it explain how the concern about circumvention has changed from 2011 to 2013 that would explain the difference between "identical" and "substantially identical."

4. Independent Account Controller Exemption

We commend the Commission's inclusion of an IAC exemption that allows asset management companies to disaggregate the positions of customer accounts controlled by an IAC. We also commend the Commission for proposing to allow managers of employee benefit plans in proposed 150.4(b)(5) to qualify as IACs. We do have concerns, however, with two aspects of the proposed IAC exemption, described below.

4.1. The definition of IAC[43] should not be limited based upon CPO or CTA status.

The status of entities as registered, exempt or excluded CPOs or CTAs has nothing to do with the purpose behind the IAC: to provide for a safe harbor from aggregation requirements where there is no shared ownership or control between a parent advisor and sub-advisors. The Commission has not articulated a reason why IAC status should be limited to certain registrants on the one hand and certain exempt or excluded entities on the other. All pool operators and trading advisors should be able to avail themselves of the IAC exemption, irrespective of their status as registered, exempt or excluded.

4.2. The proposed IAC notice filing should not be required.

We question the utility of requiring asset managers to submit notice filings complying with proposed 150.4(c)(1) to claim the proposed 150.4(b)(5) IAC exemption. Under the Commission's current IAC exemption (17 CFR 150.3(e)), no such filing is required. The new proposed filing is unduly burdensome, particularly given the fact that we are aware of no abuses of the existing IAC exemption. In lieu of a notice filing, the Commission should consider a requirement to keep records on the eligible entity's and IAC's compliance with the conditions of the IAC exemption. If, however, the Commission requires a filing, it should allow for a simplified generic, omnibus filing that would provide the Commission notice that an eligible entity intends to use the exemption on a going-forward basis consistent with the terms of the exemption.

5. Summary

For the reasons stated above, we recommend that the Commission make the following changes in any final rulemaking adopting the 2013 Aggregation NPRM:

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[43] Proposed 150.1 defines "independent account controller" to mean a person (1) who specifically is authorized by an eligible entity, independently to control trading decisions on behalf of, but without the day-to-day direction of, the eligible entity; (2) over whose trading the eligible entity maintains only such minimum control as is consistent with its fiduciary responsibilities for managed positions and accounts to fulfill its duty to supervise diligently the trading done on its behalf or as is consistent with such other legal rights or obligations that may be incumbent upon the eligible entry to fulfill; (3) who trades independently of the eligible entity and of any other IAC trading for the eligible entity; (4) who has no knowledge of trading decisions by any other IAC; and (5) who is (i) registered as an FCM, an introducing broker, a CTA, or an associated person of any such registrant, or (ii) a general partner, managing member or manager of a commodity pool the operator of which is excluded from registration under Rule 4.5 or 4.13.

- The Commission should not adopt the proposed owned entity aggregation as proposed. Instead, the rules should be amended as discussed above in order to address the impact on passive investors that have no control over, or even knowledge of, the specific commodity derivatives trading activities of owned entities in which they have invested.

- The Commission should amend 150.4(b)(1)(iii) to only require passive investors to aggregate positions of a Commission regulation 4.13 exempt pool based on a 25% or more ownership interest when "the operator of which is exempt from registration *under §§ 4.13(a)(1) or (a)(2)*."

- The Commission should omit the requirement to aggregate investments in funds that follow "substantially identical trading strategies" from any final rulemaking.

- The Commission should expand the scope of entities eligible to become IACs, so no distinction is made based upon CPO or CTA registration, exemption or exclusion status. In addition, the IAC notice filing requirements should be eliminated.

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We appreciate your consideration of our comments. We stand ready to provide any additional information or assistance that the Commission might find useful. Should you have any questions, please do not hesitate to contact Matt Nevins at 212-313-1176 or Michael Loesch at Norton Rose Fulbright at 202-662-4552.

Sincerely,

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Enclosure 3

| asset management group

February 10, 2014
Melissa Jurgens
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington DC 20581

Re: Notice of Proposed Rulemaking – Position Limits for Derivatives (RIN 3038-AD11)

The Asset Management Group (the "AMG") [1] of the Securities Industry and Financial Markets Association ("SIFMA") appreciates the opportunity to provide the Commodity Futures Trading Commission (the "CFTC" or the "Commission") with our comments and recommendations relating to the Commission's "Position Limits for Derivatives" proposed rules ("2013 NPRM") promulgated under section 4a of the Commodity Exchange Act ("CEA" or the "Act"), as amended by section 737 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"). The AMG recognizes that regulatory action may be appropriate under certain circumstances in order to achieve the goals set forth in the CEA for setting position limits, namely to prevent market manipulation, protect against excessive speculation, ensure sufficient market liquidity for bona fide hedgers, and deter disruption to price discovery, including preventing price discovery from moving to foreign boards of trade ("FBOTs"), but continues to question whether position limits would achieve these goals, particularly as proposed under the 2013 NPRM.

AMG agrees that the Hunt brothers and Amaranth's speculative trading should "inform" a consideration of position limits rulemaking, but finds that many aspects of the Commission's proposal do little to directly address these two actors' manipulative activities while resulting in serious negative consequences for the commodity markets, AMG members, and our "Main Street" customers. We believe that under the CEA, the Commission must find that speculative position limits are "necessary" and "appropriate" and balance several countervailing statutory factors on a contract-by-contract basis before promulgating position limits rules. The Commission has not met these statutory requirements in promulgating the 2013 NPRM. We believe the Commission should therefore withdraw this proposal to make the needed findings. Nevertheless, if the Commission determines to proceed with the proposal, then it can better effectuate the goals of CEA section 4a by making the following changes:

[1] The AMG's members represent U.S. asset management firms whose combined assets under management exceed $20 trillion. The clients of AMG member firms include, among others, registered investment companies, ERISA plans, and state and local government pension funds, many of whom invest in commodity futures, options, and swaps as part of their respective investment strategies.

- modifying the proposed spot-month limits and withdrawing or increasing the non-spot-month position limit levels;
- provide designated contract markets ("DCMs") and swap execution facilities ("SEFs") more discretion with respect to aggregation requirements and other rules related to position limits;
- preserving the risk management exemption from speculative positions consistent with the terms of the CEA, as informed by administrative precedent and legislative history;
- granting counterparties to "commodity index contracts" an exemption for managing price risk associated with "commodity index contract" positions;
- exempting registered investment companies and ERISA accounts from speculative position limits; and
- extending grandfather relief to pre-existing positions.

1. *Background on the AMG members' interest in speculative position limits regulations.*

The AMG's members represent U.S. asset management firms whose customers include, among others, registered investment companies, private funds, institutional accounts, ERISA plans and state and local government pension funds, many of whom invest in commodity derivatives as part of their investment strategies. Many of the funds and accounts that AMG members manage generally track a commodity index (*e.g.*, the Dow Jones-UBS commodity index). In addition to managing funds that specialize in commodities-related investments, many AMG members manage asset allocation funds that invest in the commodity markets, thereby enabling investors to obtain exposure to an asset class other than equities and bonds within one balanced and diversified portfolio.

Commodities represent a very small portion of assets under management by AMG members. Nevertheless, commodities represent an important asset class to investors. Through these funds and accounts that invest in commodity derivatives, AMG members offer a convenient, well-established mechanism for individuals, pension funds, retirement plans and other investors to diversify their overall investment portfolios with exposure to the commodity markets. Commodity-linked derivatives also allow prudently managed funds and accounts to mitigate economic risk, such as inflation and foreign exchange movements, and increase overall purchasing power.

Accordingly, members of the AMG have a strong interest in the proper functioning of commodity derivatives and commodities markets without undue restriction. The ability of AMG members to provide investor exposure to commodities as an asset class through these funds and accounts will be directly affected by any position limits rules adopted by the Commission. Any rules that are overly restrictive could adversely affect not only AMG members and the "Main Street" investors that invest in the products they manage, but also the U.S. commodity markets generally, potentially impairing price discovery and liquidity, which in turn could result in increased prices for all participants in the commodity derivatives market. In particular, restrictive limits could harm commodity producers and end-users who rely on these funds and accounts to take the other side of risk-reducing trades and provide a stable pool of liquidity. As the Commission determines whether and at what levels to set position limits, the AMG respectfully

submits that it consider the important portfolio diversification mechanism that AMG members provide to investors seeking diversified exposure to commodities, and the adverse impact that position limits may have on AMG members and investors that invest in the products they manage.

2. *The Commission should make findings of necessity and appropriateness of its position limits regime based on a fact-intensive, contract-by-contract analysis.*

The Dodd-Frank Act placed several constraints on the Commission's exercise of CEA section 4a(a)(2) authority to impose position limits designed to ensure that position limits are imposed only when "necessary" and "appropriate" and that they strike an optimal balance among a series of factors.[2] With respect to the requirements to impose position limits when they are "necessary" and "appropriate" we refer to, and agree with, the joint International Swaps and Derivatives Association ("ISDA") and SIFMA comment letter submitted on the 2013 NPRM.[3] With respect to the statutory factors, the CEA requires that the Commission address six countervailing factors or goals as it promulgates position limit rules (the "Six Factors").[4] The Commission must strive to meet the "goals" of CEA section 4a(a)(2)(C) by "striv[ing] to ensure" that (Factor 1) "trading on foreign boards of trade in the same commodity will be subject to comparable limits" and that (Factor 2) "any limits to be imposed by the Commission will not cause price discovery in the commodity to shift to trading [to FBOTs]."[5] CEA section 4a(a)(3)(B) directs the Commission to balance four additional factors when exercising its CEA section 4a(a)(2) authority:

- (Factor 3) to diminish, eliminate, or prevent excessive speculation causing sudden or unreasonable fluctuations or unwarranted changes in price;
- (Factor 4) to deter and prevent market manipulation, squeezes, and corners;
- (Factor 5) to ensure sufficient market liquidity for bona fide hedgers; and
- (Factor 6) to ensure that the price discovery function of the underlying market is not disrupted.[6]

In order to establish speculative position limits that address these factors "to the maximum extent practicable," the Commission would need to consider each commodity

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[2] *See also* CEA section 4a(a)(1) and *ISDA v. CFTC,* No. 11-cv-2146 at 15 (D.D.C. Sept. 28, 2012), available at http://www.futuresindustry.org/downloads/USDC-DC_Position-Limits-Rule-Injunction_092812.pdf ("The precise question, therefore, is whether the language of Section [4a(a)(1)] clearly and unambiguously requires the Commission to make a finding of necessity prior to imposing position limits. The answer is yes.").

[3] *See* Letter to CFTC from ISDA and SIFMA Re: Notice of Proposed Rulemaking – Position Limits for Derivatives (RIN 3038-AD99) (Feb. 10, 2014), *available at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=59611&SearchText=.

[4] These Six Factors are separate from any other considerations, including a finding of necessity, required under CEA section 4a(a)(1) or any other consideration included in a finding of appropriateness. The Six Factors provide a purpose for the speculative position limits regime the Commission may impose under CEA section 4a(a)(2).

[5] CEA section 4a(a)(2)(C).

[6] CEA section 4a(a)(3)(B).

individually because the calculus required to fully maximize these factors would differ based on characteristics specific to each commodity contract market, as discussed further below.[7] The requirement to conduct a fact-intensive contract-by-contract analysis of which contracts should be subject to position limits also is supported by administrative precedent.[8] These factors also apply to rules that affect the efficacy of position limits. We believe the Commission must analyze each exercise of discretion it proposes to undertake in establishing position limits under these Six Factors.

2.1. The AMG agrees that the Hunt brothers and Amaranth's speculative trading should "inform" a consideration of position limits.

While the 2013 NPRM proposes to issue position limits rules without a finding of necessity, "in an abundance of caution," it makes a general finding of necessity citing two historic episodes: (1) Hunt brothers (1979-1980) and (2) Amaranth (2006). Amaranth and the Hunt brothers shared one important feature in common: both were "pure speculator[s]"[9] that did not have financial or physical exposures that offset the risk exposures created by their extremely large natural gas or silver derivatives positions (respectively). The Commission claims that these two firms' speculative trading "inform" the Commission's proposal.[10]

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[7] We note that in our interpretation of CEA section 4a(a)(2)'s "as appropriate" language, the Commission must make a fact-driven interpretation that position limits are appropriate and, if so, that the limits it has selected are also appropriate, regardless of whether the Commission must make a finding of necessity before establishing position limits.

[8] In the 2013 NPRM, the Commission cites a rulemaking from 1981 ("1981 Rulemaking") as supporting its assertion that the Commission only has "to determine that excessive speculation is harmful to the market and that limits on speculative positions are a reasonable means of preventing price disruptions in the marketplace that place an undue burden on interstate commerce" to meet the requirements of CEA section 4a(a)(1). 78 Fed. Reg. at 75,683 at fn. 34, *citing* 46 Fed. Reg. at 50,940. The 2013 NPRM ignores, however, that the 1981 Rulemaking imposed speculative position limits only after a fact-intensive inquiry into the characteristics of individual contract markets in order to determine limits "most appropriate" for "an individual contract market." 46 Fed. Reg. at 50,940 ("[CEA section 4a] represents an express Congressional finding that excessive speculation is harmful to the market, and a finding that speculative limits are an effective prophylactic measure." Consistent with this, the Commission promulgated rules directing DCMs to "employ their knowledge of their individual contract markets to propose the position limits they believe most appropriate."). In other words, DCMs' deployment of "knowledge" of an "individual contract market" allowed DCMs to implement position limits "most appropriate" for that market. Furthermore, in the 1981 Rulemaking, the Commission found that specific speculative position limits designed to combat excessive speculation should be carefully calibrated so as not to "interfere with normal trading patterns or significantly impact market liquidity or pricing efficiency… [or] cause [the preponderance] of speculative traders to conduct their trading in a foreign futures market." 46 Fed. Reg. at 50,940-50,941 ("The Commission is aware that speculation is often an important contributing factor to market liquidity and pricing efficiency. […] In this respect, the Commission indicated that in its review of proposed [DCM] speculative limits, it will consider the historical distributions of speculative positions considering, among other things, recent trends in position patterns, the frequency of positions occurring at different levels and the levels at which occur the preponderance of speculative positions normally observed in the market.").

[9] *Id*. at 75,692 at note 103 ("Amaranth was a pure speculator that, for example, could neither make nor take delivery of physical natural gas."). "The Hunt brothers were speculators who neither produced, distributed, processed nor consumed silver." *Id.* at 75,686.

[10] *Id.* at 75,685.

The Hunt brothers exemplify two forms of manipulation: cornering a physical market to benefit a large leveraged derivatives position and the short squeeze.[11] Amaranth is an example of "banging the close" manipulation[12] coupled with "excessive speculation" in the form of large calendar spread speculative positions that, at times, amounted to as much as 40% of all of the open interest on the New York Mercantile Exchange ("NYMEX") for the winter months (October 2006 through March 2007)."[13]

We agree that these two firms' abusive trading could be instructive and provide commenters the ability to compare the Commission's proposal with actual undesirable trading activity (as opposed to theoretical harms addressed by "prophylactic" limits). However, when we compare Amaranth or the Hunt brothers' trading to the 2013 NPRM's provisions, we find that many key aspects of the proposal go far beyond preventing such market abuse while imposing significant, real harm to the commodity and commodity derivatives markets and market participants. This harm is precisely what Congress sought to avoid in requiring the Commission to make a finding of appropriateness in support of position limits, including careful consideration of the Six Factors for each contract subject to position limits. We note, finally, that neither Amaranth nor the Hunt brothers were subject to an existing regulatory regime that aligned their incentives with investors, limited their leverage, required them to diversify their holdings, and required them to provide their investors transparency.

2.2. The Commission already has the power to address the purposes of CEA section 4a without a restrictive position limits regime.

The Commission's exercise of its CEA section 4a authority to impose "necessary" and "appropriate" speculative position limits should take into account its ability to prevent excessive speculation and manipulation in the absence of new speculative position limits. Concerns regarding manipulation and excessive speculation are already addressed through DCMs' and SEFs' position limits and accountability rules.[14] DCMs' (or SEFs') position accountability rules can prevent manipulative or potentially manipulative conduct, or "excessive speculation," far before a position limit is reached while not imposing unneeded constraints on large positions that

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[11] "Position limits would help to deter and prevent manipulative corners and squeezes, such as the silver price spike caused by the Hunt brothers and their cohorts in 1979–80." 78 Fed. Reg. at 75,683. The Commission defined both manipulative corners and squeezes: "A market is 'cornered' when an individual or group of individuals acting in concert acquire a controlling or ownership interest in a commodity that is so dominant that the individual or group of individuals can set or manipulate the price of that commodity. In a short squeeze, an excess of demand for a commodity together with a lack of supply for that commodity forces the price of that commodity upward." *Id.* at 75,685.

[12] *CFTC v. Amaranth*, Complaint for Injunctive and Other Equitable Relief under the Commodity Exchange Act, CA 07-CIV-6682, July 25, 2007, available at http://www.cftc.gov/ucm/groups/public/@lrenforcementactions/documents/legalpleading/enfamaranthcomplaint072507.pdf.

[13] Excessive Speculation in the Natural Gas Market, Staff Report, Permanent Subcommittee on Investigations of the Senate Committee on Homeland Security and Governmental Affairs, U.S. Senate, at 6 and 51-52 (June 25, 2007), available at http://www.levin.senate.gov/imo/media/doc/supporting/2007/PSI.Amaranth.063507.pdf ("Amaranth Report").

[14] *Speculative Position Limits-Exemptions From Commission Rule 1.61; Comex Proposed Amendments to Rules 4.47 and 4.48*, 57 Fed. Reg. 29,064, 29,065-29,066 (June 30, 1992). *See also e.g.,* CME Rulebook, Rule 560, available at http://www.cmegroup.com/rulebook/CME/I/5/5.pdf.

pose no risk.[15] Violations of these position limits are violations of federal law under CEA section 4a(e). The Commission also has surveillance capabilities (e.g., large futures and swaps trading reports,[16] swap data reporting and recordkeeping requirements,[17] "special call" authority,[18] etc.) that provide it granular visibility into the commodity derivatives and cash market activities (upon special call) of all market participants to prevent manipulation and detect excessive speculation. This increased visibility is augmented by automated surveillance systems,[19] the Commission's emergency powers under CEA section 8a(9), new Dodd-Frank anti-manipulation and disruptive trade practices authority,[20] and the Commission's whistleblower program – all of which vastly increase the probability of detecting, preventing, and taking effective action against manipulative or potentially disruptive speculative activity.

3. *Comments on specific aspects of the Commission's proposal*

If, notwithstanding our comments above, the Commission adopts speculative position limits, then it should make significant changes to the rulemaking in order to better address the CEA's Six Factors. Below, we provide comments aimed at achieving the goals embodied in CEA section 4a in light of Amaranth and the Hunt brothers. Our suggestions, if implemented, form an alternative to the Commission's proposal that would be less costly in terms of compliance costs, result in less negative consequences on liquidity and price discovery, and provide the same benefit in terms of reduced likelihood for excessive speculation and manipulation.

3.1. The proposed spot-month position limits are inappropriate because they fail to take into account the characteristics of each contract and should therefore be withdrawn or significantly altered.

3.1.1. The Commission's spot-month limit formula is arbitrary and the Commission should adopt an approach that takes into account the characteristics of each commodity market or defer to DCMs and their knowledge of individual markets to determine appropriate spot-month position limit levels.

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[15] *See e.g.,* CBOT Rulebook, Rule 560, available at http://www.cmegroup.com/rulebook/CBOT/I/5/5.pdf.

[16] *See* 17 CFR parts 15, 16, 17, 18, and 20.

[17] *See* 17 CFR part 45.

[18] *See e.g.,* 17 CFR 18.05 and 17 CFR 20.6.

[19] *See* CFTC Market Surveillance Program, http://www.cftc.gov/IndustryOversight/MarketSurveillance/CFTCMarketSurveillanceProgram/tradepracticesurveillance (last visited Jan. 26, 2013) ("Trade violation detection software will perform sophisticated pattern recognition and data mining to automate basic trade practice surveillance. Among other things, TSS will provide Commission staff with the necessary tools to conduct inter-exchange and cross border surveillance of related contracts; to detect novel and complex abusive practices in today's high-speed, high volume global trading environment; and to perform timely and customized analyses of all trading activity as well as complex, value-added surveillance in significant cases.").

[20] *See* CEA section 4c.

The Commission proposes to set spot-month position limits at 25% of estimated deliverable supply under proposed 150.2(e)(3). If a commodity market has consistently liquid cash markets, greater storage capacity, and more reliable supply, it would be unlikely to be subject to a short squeeze or susceptible to cornering, even with position limits set at higher than 25% of estimated deliverable supply.[21] We encourage the Commission to provide a means by which more appropriate spot-month position limit levels may be established. We therefore recommend the Commission either adopt an approach that takes into account the characteristics of each commodity market or, consistent with the terms of CEA section 4a and administrative precedent, that the Commission defer to DCMs and their knowledge of individual markets to determine appropriate spot-month position limit levels.

3.1.2. The Commission's spot-month limit determination process should be explained further in order to avoid arbitrary and potentially harmful outcomes.

Under proposed 150.2(e)(3), DCMs listing physical-delivery referenced contracts would be required to submit, every two years, estimates of deliverable supply. The Commission indicates that it will defer to DCMs' estimate of deliverable supply unless it "determines to rely on its own estimate."[22] The Commission gives no indication as to when or under what standard it will determine to "rely on its own estimate," leaving open the possibility of arbitrary determinations that could be harmful to the markets. We recommend the Commission provide specific criteria both for when it determines not to rely on the DCMs' estimate and as to how it will formulate its own estimates of deliverable supply in such circumstances. We also recommend that the Commission estimates be subject to notice and comment.

3.1.3. Market participants should be permitted to net their cash-settled and physically-settled positions in a spot month in order to accurately reflect their aggregate spot-month positions.

Under proposed 150.2(a), the Commission proposes separate federal physical-delivery spot-month position limits and aggregate cash-settled position limits. The Commission has not demonstrated that these separate limits are necessary. We understand one motivation behind this proposal is a theoretical concern that a market participant could establish an unrestricted long position in the physical-delivery contract held through the end of the spot month resulting in a delivery obligation for its counterparties that is offset with a cash-settled position. Market discipline is generally sufficient to deter such trading behavior. While maintaining the long physical-delivery position could be used to effect a short squeeze, the trader in this scenario would not benefit from any price spike caused by a short squeeze – indeed, their short positions would result in substantial losses. More importantly, the danger to market integrity under this scenario is adequately addressed by DCMs' and futures commission merchants' rules and by procedures designed to ensure that market participants that hold a long or short position into a

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[21] *See* 17 CFR 1.61(a)(2)(1991).

[22] 78 Fed. Reg. at 75,728; proposed 150.2(a)(3)(i).

delivery period actually have the ability to take or make delivery.[23] Conversely, allowing market participants to net physically-settled and cash-settled contracts would more accurately reflect net positions. We see no reason why such netting should not be permitted.

3.2. The Commission's non-spot-month limit formula is arbitrary and the Commission should adopt an approach that takes into account the characteristics of each commodity market or defer to DCMs and their knowledge of individual markets to determine appropriate non-spot-month position limit levels.

The Commission proposes under 150.2(e)(4) to use the same formula ("open interest formula") regardless of the characteristics of the market.[24] The Commission first proposed the open interest formula in 1992 for "legacy" agricultural commodities subject to federal speculative position limits.[25] Because the Commission has not undertaken an analysis of the individual referenced contract commodity markets, its proposed non-spot-month position limits would be inappropriate for all referenced contracts. In the same 1992 rulemaking the Commission stated that the "fundamental tenet in the Commission's setting of speculative position limits is that such limits must 'be based upon the individual characteristics of a specific contract market.'"[26] The Commission also noted that "the limits which are appropriate for certain types of commodities, such as agricultural commodities, may [not] be appropriate for other tangible or intangible commodities."[27] The Commission suggested different limits might be appropriate for non-agricultural commodities because of the "depth of the underlying cash market and ease of arbitrage [that] differ from agricultural markets."[28] For example, with respect to energy and metals commodities, the Commission found in 1992 that because these commodities generally exhibited "a high degree of liquidity," position accountability rules – rather than limits - would be adequate to address concerns relating to excessive speculation.[29]

Notwithstanding these countervailing considerations, the Commission now proposes to apply the same open interest formula to all 28 referenced contract commodities. It is unclear how the misgivings the Commission had in 1992 have been overcome. If anything, the agricultural markets now resemble the energy and metals markets of 1992 in terms of greater liquidity, which would provide support for a less restrictive formula under Commission

[23] *See* e.g., NYMEX Rulebook, Rule 716, available at http://www.cmegroup.com/rulebook/NYMEX/1/7.pdf ("each clearing member shall be responsible for assessing the account owner's ability to make or take delivery for each account on its books with open positions in the expiring contract. Absent satisfactory information from the account owner, the clearing member is responsible for ensuring that the open positions are liquidated in an orderly manner prior to the expiration of trading.").

[24] The formula would set single-month and all-months position limits at 10% of open interest for the first 25,000 contracts in a referenced contract market and 2.5% thereafter. Proposed 150.2(e)(4).

[25] *See* Revision of Federal Speculative Position Limits, Proposed Rules, 57 Fed. Reg. 12,766 (Apr. 13, 1992).

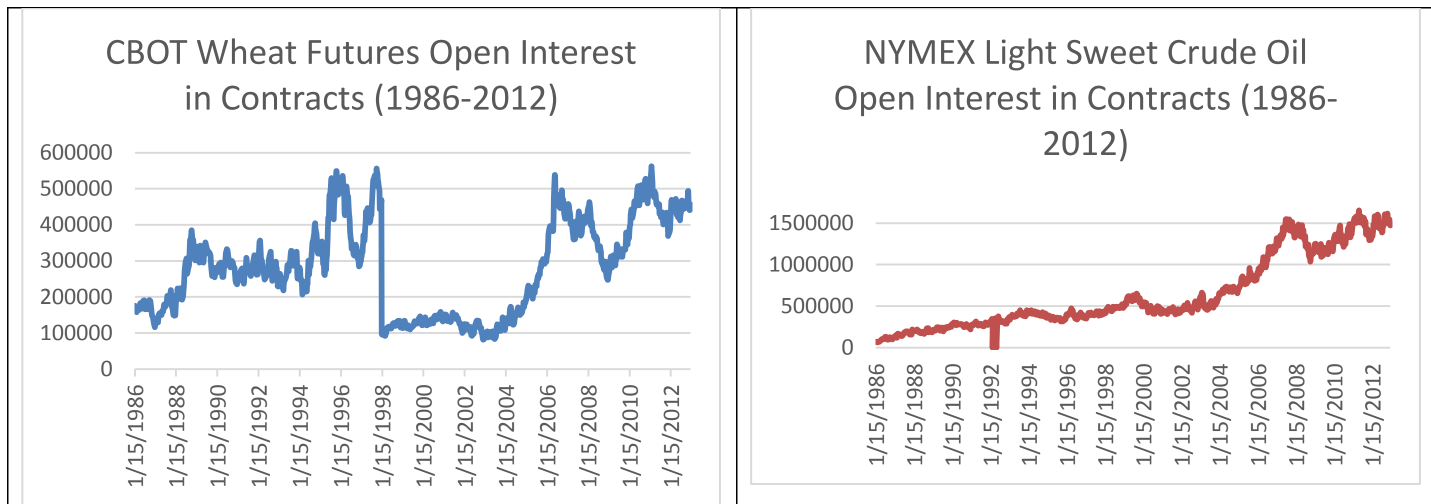
[26] *Id*. at 12,770, *citing* 52 Fed. Reg. at 6,815.

[27] *Id*.

[28] *Id*. at n. 14.

[29] 57 Fed. Reg. at 29,065-29,066 (June 30, 1992) (also finding that speculative position limits are not necessary in commodities that "have substantial forward markets that readily are arbitraged with the futures of [sic] option markets.").

administrative precedent. Take, for example, the following levels of open interest (indicative of liquidity) in the CBOT Wheat and NYMEX Light Sweet Crude Oil futures contracts:[30]



We note further that the Commission's proposed non-spot-month position limit formula results in a disparate impact that demonstrates this formula is wholly inappropriate. The limits the Commission is proposing would have widely different effects on different commodities. For example, Table 11 to the 2013 NPRM shows that in COMEX Copper referenced contracts, 16 unique enterprises would have been over the Commission's speculative position limit levels in 2011-2012. In contrast, in many other referenced contract markets, the number of overages is few. Is this because there is more "excessive speculation" in COMEX Copper than in NYMEX Henry Hub Natural Gas, for example (which Table 11 describes as having zero non-spot-month overages)? It does not attempt to explain that there is any rationale behind this disparate impact. The Commission does not explain whether any, all, or some of the overages it has indicated in Table 11 result from speculative positions or from bona fide hedging positions or from a combination of the two. Essentially, what Table 11 indicates is that the impact of the Commission's non-spot-month position limits is random – demonstrating that the non-spot-month formula and the limits that result from it are entirely arbitrary and have no relationship to preventing excessive speculation or manipulation. If the Commission is to set non-spot-month limits at arbitrary levels, it should do so at very high levels in order to prevent the types of harms unduly restrictive position limits can have, as reflected in the statutory Six Factors.

Finally, the Commission's proposed non-spot-month position limits do not increase the likelihood of preventing the excessive speculation or manipulative trading exemplified by Amaranth or the Hunt brothers relative to the status quo. We note that the large non-spot-month positions of Amaranth and the Hunt brothers could have been addressed by DCMs and SEFs under position accountability rules.[31] In the case of Amaranth, NYMEX did, in fact, cap

[30] Data taken from the CFTC's Historical Compressed Commitment of Traders Report, http://www.cftc.gov/MarketReports/CommitmentsofTraders/HistoricalCompressed/index.htm (last visited Jan. 26, 2014).

[31] CEA sections 5(d)(5)(A) and 5h(f)(6)(A) ("To reduce the potential threat of market manipulation or congestion, especially during trading in the delivery month," a DCM or SEF shall adopt for each contract, "as is necessary and appropriate, position limitations or position accountability for speculators.").

Amaranth's speculative positions on its exchange. Amaranth responded by taking advantage of a regulatory arbitrage opportunity: "[i]n August 2006, Amaranth traded natural gas on [the then unregulated InterContinental Exchange ("ICE") OTC platform] rather than NYMEX so that it could trade without any restrictions on the size of its positions."[32] The Amaranth Report recommended therefore, most pertinently, that: (1) the Congress should give the Commission authority to regulate electronic OTC markets (e.g., ICE at the time)[33] and (2) the Commission "should monitor aggregate positions on NYMEX and ICE for all of the months in which contracts are traded, not just for contracts near expiration."[34] This concern from 2006 would not exist under today's rules. Under the Commission's part 37 rules relating to SEFs it now has authority over all multilateral derivatives trading platforms (ICE would have been a SEF) and the Commission's expanded part 20 and its part 45 reporting rules now enable it to monitor all futures and swaps positions. Notably, the Amaranth Report did not recommend that the Commission establish non-spot-month position limits for natural gas, the 28 referenced contract commodities, or all physical commodity derivatives.

In order to ensure that the Commission's speculative position limits "to the maximum extent practicable" achieve the goals of CEA section 4a, AMG recommends therefore that the Commission take one of three non-exclusive actions: (1) decline to adopt non-spot-month position limits; (2) set non-spot month limits at levels where they are unlikely to affect any persons until the Commission is able to develop a factual record to justify restrictive limit levels under the Six Factors and other purposes of CEA section 4a; or (3) re-propose its speculative position limits proposal after utilizing the expertise and resources of DCMs and SEFs to determine "appropriate" non-spot-month position limit levels as the Commission has done traditionally.[35]

3.3 DCMs and SEFs should be given more discretion to determine appropriate aggregation and other requirements relating to speculative position limits.

The 2013 NPRM proposes to limit the discretion of DCMs and SEFs ("exchanges" collectively) in their administration of speculative position limits in two important ways including:

(1) under proposed 150.5(a)(5), aggregation requirements must "conform to" those of the Commission under proposed 150.4; and

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[32] Amaranth Report at 6.

[33] *Id*. at 8.

[34] *Id*. Significantly, the Amaranth Report did not recommend changes to the Commission's position limits regime. Its recommendation that the Amaranth problem be addressed, in part, by statutory authority for the Commission to regulate electronic OTC markets was achieved through the enactment in 2008 of the Food, Conservation and Energy Act of 2008, Public Law 110-246, 122 Stat. 1624 (June 18, 2008).

[35] In 1981, the Commission finalized rules directing DCMs to "employ their knowledge of their individual contract markets to propose the position limits they believe most appropriate." Establishment of Speculative Position Limits, 46 Fed. Reg. 50,938, 50,940. In other words, DCMs' deployment of "knowledge" of an "individual contract market" enabled DCMs to implement position limits "most appropriate" for that market. *Id.* The Commission also stated that it "endorse[d]" the "concept" that "the exchanges are in the best position to determine the most efficacious level at which position limitations may be established." *Id*. at n. 5. *See also* 17 CFR 1.61(a)(2) (1981).

(2) under proposed 150.5(a)(2)(i), limiting their discretion to defining the scope of hedge and other exemptions to those that conform to the Commission's definitions.

As discussed above, the Commission has traditionally followed the principle that exchanges have superior knowledge of individual contract markets enabling them to implement position limits and related aggregation requirements and exemptions "most appropriate" for that market.[36] Consistent with this principle, we urge the Commission to provide exchanges broader discretion in determining aggregation rules and exemptions, subject to Commission oversight. Providing the exchanges this broader discretion would enable them to more effectively and efficiently further the purposes of CEA section 4a by tailoring these requirements to the individual commodity contract markets. The need for broader exchange discretion is particularly warranted in the non-referenced contracts, including excluded commodities, that the Commission has not considered in any depth in this rulemaking. We note finally that the Commission has not considered the costs borne by exchanges and market participants from the prescriptive approach to exchange-administered position limits, including exchange aggregation notice filing and application requirements conforming to proposed 150.4(c)(1) and (c)(2). For example, under proposed 150.4(c), the Commission would require notice and application filings for market participants seeking an aggregation exemption. The Commission should allow and encourage exchanges to tailor such requests for aggregation relief to the markets they regulate.[37]

3.4 Bona fide hedging exemption.

3.4.1. The Commission should preserve the risk management exemption.

Commission staff historically provided a bona fide hedging exemption for positions that offset risks related to swaps or similar OTC positions involving both individual commodities and commodity indexes ("risk management exemption").[38] These exemptions were subject to specific conditions to protect the market, including: (1) the futures positions must offset specific price risk; (2) the dollar value of the futures positions must be no greater than the dollar value of the underlying risk; and (3) the futures positions must not be carried into the spot month.[39]

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[36] In 1981, the Commission finalized rules directing DCMs to "employ their knowledge of their individual contract markets to propose the position limits they believe most appropriate." 46 Fed. Reg. at 50,940. This included aggregation and exemption rules. *See* 17 CFR 1.61 (1982).

[37] AMG is commenting separately on the Commission's aggregation proposal, Aggregation of Positions, 78 Fed. Reg. 68,946 (Nov.15, 2013).

[38] "Position Limits and the Hedge Exemption, Brief Legislative History," Testimony of General Counsel Dan M. Berkovitz, Commodity Futures Trading Commission, July 28, 2009, available at http://www.cftc.gov/PressRoom/SpeechesTestimony/berkovitzstatement072809.

[39] *Id. See also* CFTC Form 40, Part B, Item 3 and Schedule 1 (defining "hedging" as including "asset/liability risk management, security portfolio risk, etc.").

The Commission proposes to eliminate the risk management exemption on the basis of CEA section 4a(c)(2)'s definition of a "bona fide hedging transaction or position" ("statutory definition"), which was added by Dodd-Frank. CEA section 4a(c)(2) was modeled on 17 CFR 1.3(z) ("regulatory definition") with one important difference: the statutory definition of a "bona fide hedging transaction or position" did not include the term "normally" in presenting the "temporary substitute criterion," which provides that a bona fide hedge position should "normally represent[] a substitute for transactions made or to be made or positions taken or to be taken at a later time in a physical marketing channel." (emphasis added) The Commission proposes to interpret this omission as meaning that a bona fide hedging position must represent a "substitute for transactions made or to be made in a physical marketing channel."[40] In other words, the hedge position is "a temporary substitute for a cash transaction that will occur later."[41]

By eliminating the risk management exemption, the Commission's speculative position limits rules would go beyond deterring excessive speculation and manipulation and would have the effect of deterring and constraining liquidity by market participants with non-speculative positions in commodity derivatives – essentially deterring non-speculative, prudent risk management. Commodity funds and asset allocation funds, for example, utilize commodity derivatives in active or passive management strategies in order to provide diversified, commodity-based returns to their clients and to mitigate economic risk. Reduced liquidity would also result in increased prices for all participants in the commodity derivatives market.

We urge the Commission to reconsider eliminating the risk management exemption. A risk management position represents a non-speculative, flat-risk position and should therefore be exempt from speculative position limits. The risk management exemption also encourages the provision of liquidity across financial and physical markets and therefore furthers the goals of promoting liquidity for bona fide hedgers and price discovery. We note that neither Amaranth nor the Hunt brothers used the risk management exemption and therefore its elimination is not warranted if those two actors' trading activity is to provide any guidance to the Commission as to the regulatory changes that it should implement. Indeed, speculative position limits under CEA section 4a are intended to target excessive speculation and manipulation,[42]and risk management positions present zero risk of either. As discussed below, we do not believe the elimination of the risk management is compelled by CEA section 4a(c)(2) and the Commission has ample authority to exempt risk management positions under CEA section 4a(a)(7).

3.4.1.1. The Commission has ample authority under CEA section 4a(a)(7) to exempt risk management positions.

Representative Lucas, the Ranking Member of the House Agriculture Committee that authored CEA section 4a(c)(2)'s bona fide hedging language strongly cautioned against overly

[40] 78 Fed. Reg. at 75,709.

[41] *Id.* at 75,686 at fn. 70.

[42] CEA section 4a(a)(1). CEA sections 4a(a)(4) and 4a(a)(5) provide further evidence that Congress wanted to ensure that market participants could net price risk in related products, "significant price discovery function" and "economically equivalent" swaps, with futures price risk.

strict position limits with overly narrow exemptions.[43] Representative Lucas urged the Commission to "make use of the exemptive authority granted by the [CEA] to avoid establishing position limits which would force widely-held funds or firms to divest their current holdings in highly regulated products."[44] Congress did not intend, he continued, that the Commission establish speculative position limits in a manner that "impair[s] price discovery for commercial producers and their counterparties, and cause unnecessary harm to the futures markets and small investors."[45]

Under CEA section 4a(a)(7), the Commission may exempt any persons or transactions from position limits. Proposed 150.3(e)(2) provides that the Commission "may request" relief from the Commission for "risk-reducing practices commonly used in the market." The Commission does not explain specifically under what circumstances this relief may be granted.

We believe the Commission should provide for a means to obtain reliable and predictable relief for risk management positions under the Commission's CEA section 4a(a)(7) authority. The Commission should provide for a risk management position exemption under the conditions of the Commission's past risk management exemption, i.e., (1) the exempted positions must offset specific price risk; (2) the dollar value of the futures positions must be no greater than the dollar value of the underlying risk; and (3) the futures positions must not be carried into the spot month. These conditions ensure the exemption would not be abused. The Commission could grant such relief in a manner similar to the bona fide hedging exemption in proposed 150.3(a)(1)(i).

3.4.1.2. Eliminating the risk management exemption is not compelled by CEA section 4a(c)(2).

The Commission's rationale in proposing to eliminate the risk management exemption is based on the omission of a single word in CEA section 4a(c)(2)'s "bona fide hedging transaction or position" definition. We urge the Commission to reconsider its interpretation of the omission of the term "normally" in CEA section 4a(c)(2)'s temporary substitute clause and to interpret that clause as it has been traditionally interpreted under applicable administrative precedent: as a non-restrictive condition providing further indication that the risks being hedged under the exemption arise from operation of a commercial enterprise.

In the Commission's 1987 "Clarification of Certain Aspects of the Hedging Definition," ("1987 Clarification"), the Commission provided background on the meaning of the temporary substitute criterion of 17 CFR 1.3(z).[46] In the 1987 Clarification, the Commission pointed out

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[43] Letter dated December 16, 2010 from Congressman Spencer Bachus and Congressman Frank Lucas to the Honorable Timothy Geithner, the Honorable Gary Gensler, et al. (the "Bachus/Lucas Letter"), available at http://online.wsj.com/public/resources/documents/bachus.pdf ("Overly prescriptive position limits would drain existing liquidity from the capital markets, impair price discovery for commercial producers and their counterparties, and cause unnecessary harm to the futures markets and small investors.").

[44] *Id*.

[45] *Id*.

[46] Clarification of Certain Aspects of the Hedging Definition, 52 Fed. Reg. 27,195, 27,196 (July 20, 1987).

that in first proposing a definition of bona fide hedging position in 1977, the Commission did not include the term "normally."[47] The Commission added the term "normally" in response to commenters to "provide *further* indication" that the temporary substitute criterion was *not* to be "construed as a restrictive, *necessary condition* for the bona fide hedging" exemption (emphasis added). In 1977, the Commission explained that the intention behind the proposed definition of bona fide hedging position was "to set out the basic conditions which must be met by a bona fide hedging transaction or position; i.e. that it must be economically appropriate to risk reduction, such risks must arise from operation of a commercial enterprise, and the price risk fluctuations of the futures contract used in the transaction must be substantially related to fluctuations of the cash market value of the assets, liabilities, or services being hedged."[48] The Commission has not, until 2011, intended to make the temporary substitute criterion a necessary requirement for the bona fide hedging exemption.

Similarly, in its 1987 "Guidelines for Risk Management Exemptions," the Commission noted that the concerns it sought to address with speculative position limits related primarily to "derivative market positions lacking an offsetting cash or derivative market position." For market participants claiming a risk management exemption, they have an offsetting derivatives position and should be able to claim an exemption for managing these risks.

3.5 The AMG welcomes exclusion of "commodity index contracts" but recommends that counterparties to "commodity index contracts" be provided an exemption for managing commodity index contract position risks.

3.5.1. "Commodity index contract" exclusion.

We welcome the exclusion of "commodity index contracts"[49] from the proposed definition of "referenced contract." We agree with the Commission's rationale for this exclusion. Commodity index contracts do not "involve a separate and distinct exposure to the price of a referenced [] contract's commodity" price.[50] This provision benefits many asset managers and their customers who invest in such products in order to gain price exposure to a diversified array of commodities over a diverse set of maturities. The liquidity added to commodity markets by these investments is particularly beneficial in longer dated maturities where liquidity can be scarce. Commercial, bona fide hedgers that might use long-dated commodity derivatives can more cost-effectively establish long-term hedges because of the liquidity that commodity index contracts provide.

3.5.2. The Commission should provide a risk management exemption for positions hedging the price risk of "commodity index contracts."

[47] *Id*. citing 42 Fed. Reg. at 14,833.

[48] *Id*.

[49] "Commodity index contract means an agreement, contract, or transaction that is not a basis or any type of spread contract, based on an index comprised of prices of commodities that are not the same or substantially the same." Proposed 150.1.

[50] Federal Speculative Position Limits for Referenced Energy Contracts and Associated Regulations, 75 Fed. Reg. 4,144, 4,153 (Jan. 26, 2010).

As discussed above in section 3.4, we urge the Commission to reinterpret its bona fide hedging exemption to include risk management positions, inclusive of price risk associated with commodity index contract positions. If it declines to do so, we urge the Commission to extend a risk management exemption for the limited purpose of managing the price risk associated with commodity index contract positions, consistent with the intention behind excluding commodity index contract positions. We note that currently, counterparties to commodity index swaps can remain in compliance for exceeding a position limit based on a position hedging "commodity index contract" price risk under DCM risk management exemptions. We believe that counterparties to commodity index swaps should be able to manage the risk of these contracts without these positions counting against their limits.

3.5.3. Benefits arising from commodity index investment and the costs borne by deterring commodity index investment.

AMG believes that evidence supports the many benefits offered to commodity markets by commodity index funds and accounts, whose long-term diversified investments enhance stability, price discovery and producer hedging. Recognizing these benefits, Senator Blanche Lincoln stated in a July 16, 2010 Senate Colloquy that commodity index participation, in addition to the benefits it provides investors, may "also serve to provide agricultural and other commodity contracts with the necessary liquidity to assist in price discovery and hedging for the commercial users of such contracts."[51]

These considerable benefits will be significantly reduced if the Commission determines not to grant the relief we have requested. Our members noted that leading up to the effective date of the Commission's vacated part 151 position limits rules (a rulemaking that also excluded "commodity index contracts" and also did not provide for an exemption for positions offsetting commodity index contract price risk), our members noticed less liquidity and noticeably worse pricing for commodity index swaps. These results were due to the expectation of counterparties that our members trade with that their ability to manage the risk offsetting commodity index swaps would be hindered under the anticipated part 151 rules. Our members would expect to incur similar costs under the Commission's new proposed rules. Furthermore, during the run-up to the effective date of the Commission's vacated part 151 position limits rules, our members were finding that they needed to transact with additional counterparties in order to trade commodity index swaps as their counterparties were concerned with hitting limits. As a result, many of our members were preparing to initiate trades with less creditworthy counterparties in order to source liquidity.

We note finally that neither Amaranth nor the Hunt brothers were in any way involved in commodity index swaps. Reducing the ability of commodity index swap counterparties to

[51] Blanche Lincoln, Senate Colloquies, July 16, 2010: "I wish to also point out that section 719 of the conference report calls for a study of position limits to be undertaken by the CFTC. In conducting that study, it is my expectation that the CFTC will address the soundness of prudential investing by pension funds, index funds and other institutional investors in unleveraged indices of commodities that may also serve to provide agricultural and other commodity contracts with the necessary liquidity to assist in price discovery and hedging for the commercial users of such contracts."

manage the risk associated with their swap positions therefore would present no beneficial effect on the Commission's ability to prevent the type of trading conducted by these two bad actors.

3.6. The Commission should exempt registered investment companies and ERISA accounts from speculative position limits.

Registered investment companies ("RICs") and ERISA accounts are subject to stringent regulatory requirements that ensure that the incentives of the investment adviser are aligned with those of the customers.[52] These rules and regulations ensure that RICs and ERISA accounts do not engage in the kind of "excessive speculation" or manipulative trading exemplified by Amaranth or the Hunt brothers. Unlike RICs and ERISA accounts, Amaranth was an unregulated private fund.[53] Amaranth had a leverage ratio that ranged from five to eight times capital, which resulted in more market pressure when Amaranth was forced to unwind positions.[54] Being unregulated, Amaranth's investors had little transparency in how dangerously exposed Amaranth was to natural gas prices.[55] Not subject to diversification requirements, Amaranth had extreme exposures to just a few natural gas settlement prices.[56]

In contrast to Amaranth and the Hunt brothers, RICs and ERISA accounts are subject to existing regulatory regimes that align their incentives with investors, limit their leverage, require them to diversify their holdings, and require them to provide transparency to their investors. RICs are required to comply with all regulations and related guidance under the Investment Company Act of 1940 (the "Investment Company Act"), including those regarding counterparty limits, liquidity and asset coverage and the use of leverage. The Investment Company Act limits the amount of leverage that a RIC may obtain, including through the use of derivatives, by requiring the fund to segregate liquid assets or hold offsetting positions on its books in an equivalent amount.[57] Unleveraged funds significantly reduce market pressure in the event of any forced unwinding of positions, and are substantially less likely to liquidate due to market movements than leveraged funds like Amaranth.

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[52] *See* letter dated December 16, 2010 from Congressman Spencer Bachus and Congressman Frank Lucas to the Honorable Timothy Geithner, the Honorable Gary Gensler, et al. (the "Bachus/Lucas Letter"), available at http://online.wsj.com/public/resources/documents/bachus.pdf ("We hope that the [CFTC] will make use of the exemptive authority granted by the [CEA] to avoid establishing position limits which would force widely-held funds or firms to divest their current holdings in highly regulated products. Overly prescriptive position limits would drain existing liquidity from the capital markets, impair price discovery for commercial producers and their counterparties, and cause unnecessary harm to the futures markets and small investors.").

[53] Amaranth Report at 57.

[54] *Id.* at 58.

[55] *See* The Amaranth Debacle: A Failure of Risk Measures or a Failure of Risk Management?, Ludwig B. Chincarini, Journal of Alternative Investment (2007), available at http:// pages.pomona.edu/~lbc04747/pubs/pub10.pdf.

[56] *See e.g.,* Amaranth Report at 60-64.

[57] Section 18(f) of the Investment Company Act; *see also* Securities Trading Practices of Registered Investment Companies, Investment Company Act Release No. 10666 (Apr. 18, 1979); Merrill Lynch Asset Management, L.P., SEC No-Action Letter (July 2, 1992); Dreyfus Strategic Investing & Dreyfus Strategic Income, SEC No-Action Letter (June 22, 1987).

RICs electing to be "diversified companies" under the Investment Company Act are required to follow strict diversification requirements, including restrictions against investing more than 5% of total capital in any single issuer, and requirements to invest at least 75% of total assets in cash and securities.[58] In addition, RICs must maintain at least 85% of their assets as liquid investments, are required to calculate and publish net asset values and disclose substantial information about their investments, and are obligated to maintain comprehensive compliance programs. All of these requirements help assure that RICs do not engage in manipulative practices, become too heavily concentrated in any one investment, or create systemic risk.

Additionally, under Subchapter M of the Internal Revenue Code of 1986, at least 90% of the annual gross income of a RIC must be so-called "qualifying income" in order for the RIC to maintain its tax status as a "regulated investment company." Commodities and derivatives referencing commodities generally do not produce qualifying income under current law. As a result, some RICs use wholly-owned unregistered subsidiaries to invest in commodity derivatives transactions; each subsidiary is included within the regulatory limitations applicable to its registered parent.[59] Nevertheless, any RIC's investment in such a subsidiary, and therefore its investment in commodities or commodity-related instruments, is limited to no more than 25% of a RIC's assets under the tax diversification provisions of the Internal Revenue Code.[60]

Investment advisers to ERISA accounts are subject to strict fiduciary obligations, including the duty to discharge their duties under a stringent prudence test,[61] the duty to diversify the investment of an account's assets so as to minimize the risk of large losses[62] and the duty of loyalty, which requires each adviser to discharge its duties solely in the interest of the account and for the exclusive purpose of providing benefits to participants and beneficiaries.[63] Similarly, the Investment Company Act requires advisers to RICs and other vehicles to be registered

[58] Section 5 of the Investment Company Act.

[59] Mutual funds utilizing this parent-subsidiary structure rely on IRS private letter rulings which conclude that income arising from a mutual fund's investment in a subsidiary that invests in commodities investments constitutes qualifying income. These same private letter rulings require such subsidiaries to comply with the requirements of Section 18(f) of the Investment Company Act and all related guidance regarding asset coverage and the use of leverage by mutual funds. *See, e.g.,* I.R.S. Priv. Ltr. Rul. 201039002 (June 22, 2010); I.R.S. Priv. Ltr. Rul. 201037012 (June 4, 2010); I.R.S. Priv. Ltr. Rul. 201030004 (Apr. 28, 2010). In addition, in various SEC No-Action Letters, the SEC has permitted RICs to establish wholly-owned foreign subsidiaries for the purpose of avoiding unfavorable foreign tax treatment or foreign investment restrictions, and has acknowledged that such subsidiaries did not avoid any regulatory requirements since the parent-subsidiary structures were operated in accordance with the Investment Company Act. *See, e.g.,* S. Asia Portfolio, SEC No-Action Letter (Mar. 12, 1997), Templeton Vietnam Opportunities Fund, Inc., SEC No-Action Letter (Sept. 10, 1996), The Spain Fund, Inc., SEC No-Action Letter (Mar. 28, 1988) and The Scandinavia Fund, Inc., SEC No-Action Letter (Nov. 24, 1986).

[60] Section 851(b)(3) of the Internal Revenue Code.

[61] ERISA § 404(A)(1)(B), 29 U.S.C.A. § 1104(A)(1)(B). This provision requires the manager to have conducted a sufficient investigation into the details and particulars of a transaction and its appropriateness for the account involved prior to engaging in a transaction.

[62] ERISA § 404(A)(1)(C), 29 U.S.C.A. § 1104(A)(1)(C).

[63] ERISA § 404(A)(1)(A), 29 U.S.C.A. § 1104(A)(1)(A).

themselves under the Investment Advisers Act of 1940, which subjects advisers to rigorous fiduciary duties of loyalty and care to customers as a matter of law.[64]

While RICs and ERISA accounts present virtually no risk of "excessive speculation" or manipulation, their unfettered participation in commodity markets provides valuable liquidity, particularly in long-dated maturities, that is beneficial to bona fide hedgers with long-term hedging needs. We therefore urge the Commission to exempt RICs and ERISA accounts from position limits, particularly where the risk of "excessive speculation" and manipulation is non-existent. Granting these exemptions would reduce the compliance cost associated with RIC and ERISA participation in commodity markets without any real reduction in the efficacy of position limits.

3.7. Grandfather relief.

3.7.1. Grandfather relief should not be limited to only those who do not increase their position after the effective date of a limit.

The Commission proposes at 150.2(f)(2) to exempt a referenced contract position ("a pre-existing position") acquired by a person in good faith prior to the effective date of a non-spot-month limit, on the condition that the position is not increased after the effective date of a limit. This latter condition should be eliminated because in many scenarios it appears to be inconsistent with the purposes of CEA sections 4a(b)(2) and 4a(c)(1).

CEA section 4a(b)(2) provides that position limits "shall not apply to a position acquired in good faith prior to the effective date of such rule, regulation, or order." CEA section 4a(c)(1) provides that "[n]o rule, regulation, or order issued under subsection (a) of this section shall apply to transactions or positions which are shown to be bona fide hedging transactions or positions as such terms shall be defined by the Commission by rule, regulation, or order consistent with the purposes of this chapter."

Consistent with these statutory directives, we believe that the Commission should exempt all pre-existing positions established in good faith from position limits, particularly those that are pre-existing bona fide hedging positions. Doing so should not undermine the Commission's ability to prevent another Amaranth or Hunt brothers.

3.7.2. The Commission should amend proposed 150.2 to provide for grandfather relief for positions that result from rolling forward of pre-existing positions.

AMG members' counterparties often hedge the risk of commodity derivatives positions by holding positions in futures contracts. In order for them to effectively hedge the risk associated with a pre-existing position, they would need to be able to roll these hedges from a prompt month into a deferred contract month. The Commission should therefore amend proposed 150.2(f)(2) to cover "any commodity derivative contract position *or position that*

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[64] *See* Sections 206(1) and (2) of the Advisers Act; *SEC v. Capital Gains Research Bureau, Inc.,* 375 U.S. 180, 192-93 (1963).

<u>results from transferring the price risk exposure created by such position into a deferred contract month</u> acquired in good faith…"

3.7.3. The costs associated with the Commission's narrow grandfather relief are significant.

Absent the changes we have requested above, particularly in sections 3.4.1, 3.5.1, and 3.5.2, AMG members and their customers would bear significant costs resulting from a diminished ability of AMG members to generate desired returns for customers. Without these changes, the rules as proposed would also result in diminished willingness from our counterparties to transact, resulting in unduly higher costs to enter into commodity derivatives trades. Indeed, as indicated above, AMG members witnessed a noticeable widening of the bid/ask spread, indicative of reduced liquidity, in the commodity index swaps market even before the Commission's vacated part 151 position limits rules were to take effect in 2012, which was due in part to a similarly narrow grandfather exemption under vacated 151.9.

4. *Conclusion*

As discussed above, the AMG believes that before imposing speculative position limits, the Commission must and should make fact-intensive findings of necessity and appropriateness in support of its position limits regime based on an individual contract-by-contract basis. As the Commission has failed to do so with the 2013 NPRM, we believe that it should be withdrawn. Nevertheless, if the Commission determines to proceed with this rulemaking, the Commission can better effectuate the goals of CEA section 4a by making the following changes:

- modifying the proposed spot-month limits and withdrawing or increasing the non-spot-month position limit levels;
- providing DCMs and SEFs more discretion with respect to aggregation requirements and other rules related to position limits;
- preserving the risk management exemption from speculative position limits consistent with the terms of the statute, as informed by administrative precedent and legislative history;
- granting counterparties to "commodity index contracts" an exemption for managing commodity index contract position risks;
- exempting RICs and ERISA accounts from speculative position limits; and
- expanding grandfather relief available to pre-existing positions.

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The AMG thanks the CFTC for the opportunity to comment on the proposed rulemaking concerning position limits. The AMG would welcome the opportunity to further discuss our comments with you. Should you have any questions, please do not hesitate to contact Matt Nevins at 212-313-1176 or Michael Loesch at 202-662-4552.

Sincerely,

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