July 13, 2016

VIA ONLINE SUBMISSION
Christopher Kirkpatrick, Secretary
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, N.W.
Washington, D.C. 20581

RE: Position Limits for Derivatives: Certain Exemptions and Guidance, RIN 3038-AD99

Dear Mr. Kirkpatrick:

By this letter, the National Corn Growers Association ("NCGA") and the Natural Gas Supply Association ("NGSA") respectfully submit comments regarding the U.S. Commodity Futures Trading Commission's (the "CFTC's" or "Commission's") Supplemental Notice of Proposed Rulemaking, Position Limits for Derivatives: Certain Exemptions and Guidance, 81 Fed. Reg. 38458 (June 13, 2016) (the "Supplemental Proposal"), which proposes certain revisions and additions to the regulations and guidance proposed by the Commission in its Proposed Rule, Position Limits for Derivatives, 78 Fed. Reg. 75680 (Dec. 12, 2013) (the "Proposed Rule"). NGSA submitted comments on February 10, 2014, June 26, 2014, August 4, 2014, and March 30, 2015 in response to the Commission's comment periods on the Proposed Rule and NGSA and NCGA appreciate the Commission's continued consideration of industry and end user concerns.

Founded in 1957, NCGA represents more than 40,000 dues-paying corn farmers who contribute through corn checkoff programs in their respective states. NCGA and its 48 affiliated state associations and checkoff organizations work together to create and increase opportunities for their members and the industry.

NGSA encourages the use of natural gas within a balanced national energy policy and promotes the benefits of competitive markets, thus encouraging increased supply and the reliable and efficient delivery of natural gas to U.S. customers. Founded in 1965, NGSA is the only Washington, D.C.-based trade association that focuses on producer/marketer issues related to the downstream natural gas industry.

As producers and suppliers of corn and natural gas, NCGA and NGSA members would not invest in the growth of the physical corn and natural gas markets if they did not believe the market exhibited three key principles of health—integrity, transparency and efficiency. NCGA and NGSA believe that the proposed approaches on position limits will further promote such health and respectfully request the Commission's consideration of these comments.

COMMENTS

Corn, natural gas and other commodity markets can function well under a federal position limits regime, as long as the limits are set appropriately and a robust bona fide hedge exemption is made available in accordance with the Commodity Exchange Act's ("CEA's") statutory mandate. Accordingly, NCGA and NGSA support the Supplemental Proposal overall as providing a basic structure to provide market participants needed regulatory certainty with respect to their satisfaction of the requirements for making use of the bona fide hedge exemption with respect to federal position limits. While the Supplemental Proposal is essentially limited to providing a process for designated contract markets and swap execution facilities ("exchanges") to recognize such exemptions, and other important issues concerning federal position limits remain to be addressed,[1] by providing such a process the Supplemental Proposal represents a potential linchpin solution to making the statutorily required bona fide hedge exemption practically usable in the day-to-day commercial activities of market participants. **Nonetheless, important modifications must be made with respect to the Supplemental Proposal—both to the underlying definition of "bona fide hedging position" and to the mechanics of the proposed processes for exchanges to recognize bona fide hedging**

[1]Important issues regarding position limits that are not addressed by the Supplemental Proposal must still be addressed, including: (1) updating deliverable supply methodologies and estimates to better reflect actual market conditions; (2) introducing exchange-administered accountability levels to provide any controls that would apply to non-spot month trading levels; and (3) eliminating the proposed condition that would require market participants to divest of any physically settled positions in the spot month to make use of the higher limit on cash-settled position in the spot month. As discussed in prior NGSA comments, and in the comments of many market participants, resolution of these additional issues is essential to a workable position limits regime. Position limits issues are highly interrelated, and the appropriate solution for one issue in many cases hinges on the approach taken to resolve another issue. For example, the bona fide hedge exemption process becomes especially critical if the speculative position limit is set at a level that is based on outdated deliverable supply information. Similarly, the process for obtaining an exemption for a non-enumerated bona fide hedge becomes even more critical if the list of enumerated bona fide hedges is so narrow that it does not include routine risk management practices. A market can function well with appropriately-set speculative limits that preserve liquidity *if* there is a workable, efficient hedge exemption process. Given this interconnectedness, individual issues with respect to the Commission's position limits regime cannot be resolved in a vacuum.

positions—to ensure that market participants can effectively and efficiently use the bona fide hedging exemption to engage in such hedging activities without impediment, as Congress intended. In addition, market participants must be given ample time to prepare for compliance after the exchanges obtain approval of the exchange rule changes that would be necessitated by a final rule.

I. Any Final Rule Imposing New Federal Position Limits Must Ensure the Adequate Breadth and Usability of the Bona Fide Hedge Exemption.

In the agriculture and energy industries in particular (but, indirectly, also the vast swaths of the economy that depend on them), the ability to hedge commercial risks associated with physical commodity transactions is essential. Agricultural and energy infrastructure development and transactions take place on a large scale and in complex markets, requiring limits that are in step with such scale and that provide for flexible hedge exemptions that can accommodate the unique risks encountered by agricultural and energy market participants.

In the natural gas industry, robust new natural gas supplies offer substantial opportunities for revitalization of U.S. industry, and industrial consumers are expected to invest approximately $118 billion over the next five years to accommodate increased use of natural gas. Such new investment is to a substantial degree dependent on market participants' ability to cost-effectively hedge the financial risks within the commodity markets that are associated with such investment. As an example, regional price differentials are often hedged to manage the contracted rate and flow risk of transportation. More broadly, U.S. industry and consumers depend daily on reliable and cost-effective supply of energy, and the many market participants engaged in providing such supply rely heavily on the ability to hedge their commercial risk associated with such energy supply as an essential part of engaging in such business. Thus, to the extent that speculative position limits are imposed on derivative contracts in energy and agricultural commodities, the availability of a workable bona fide hedge exemption process will be essential to the well-being of both market participants and consumers. The Supplemental Proposal makes significant strides toward providing such a process, but certain modifications are required to ensure the adequate breadth and usability of the exemption.

II. The Commission Should Make Certain Further Modifications to its Regulations and Guidance With Respect to Its Definition of "Bona Fide Hedging Position."

Although the Supplemental Proposal mostly addresses the process for obtaining recognition of a bona fide hedging position, that process is ultimately dependent on the underlying definition of a bona fide hedging position. NCGA and NGSA request that the Commission make certain modifications to its regulations and guidance with respect to its definition of "bona fide hedging position" to better reflect, and not go beyond, the

substantive standards in the CEA and to more precisely correspond to the structures of the affected commodities markets.

A. The Commission Should Not Introduce Overly Restrictive Litmus Tests With Respect to the CEA's "Economically Appropriate" Standard.

Section 4a(c)(2)(A)(ii) of the CEA provides the fundamental requirement that bona fide hedging positions be "economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise." While NCGA and NGSA agree that it is appropriate for the CFTC to provide guidance regarding the meaning of "economically appropriate," the CEA's "economically appropriate" standard is intentionally flexible. Thus, the Commission should avoid imposing arbitrary tests that would threaten market participants' abilities to effectively hedge risk, particularly if such tests are expected to be applied to non-enumerated bona fide hedging positions ("NEBFHs").

1. The Commission Should Not Limit Its Interpretation of "Economically Appropriate" to Only Include Hedges That Address Price Risk.

It is essential that the Commission not limit its interpretation of "economically appropriate" to only apply to hedges that address price risk. In the Supplemental Proposal, the Commission noted that "it interprets risk, in the economically appropriate test, to mean price risk."[2] This imposes a standard that is narrower than, and inconsistent with, the Congressional standard, which requires only that bona fide hedging positions be "economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise." There are numerous risks other than price risk that are economically appropriate to address in the conduct and management of a commercial enterprise, including operational risk, liquidity risk, credit risk, locational risk and seasonal risk. Accordingly, NCGA and NGSA request that the Commission clarify its guidance to recognize that "economically appropriate" hedges are not limited solely to hedges that address price risk, at least with respect to the proposed exemption process for NEBFHs.

Even more troubling than the Proposed Rule's suggestion that "economically appropriate" hedges are limited to those that address only price risk, some CFTC staff have indicated that they would further limit their interpretation of "economically appropriate" as only including positions that hedge <u>fixed-price risk</u> as opposed to <u>index price risk</u>.[3] NCGA and NGSA agree that hedging the risk associated with an underlying fixed price transaction may be a prototypical example of an economically appropriate hedge. However, market participants can and do encounter price risks associated with

[2] Supplemental Proposal at 38463.

[3] In natural gas markets, index price risk would include discount/premium changes and the spread between "first of the month" and daily indices.

index transactions that they also find economically appropriate to hedge. In fact, for this reason, ICE Futures U.S.'s ("ICE's") spot month exemption request form includes line items for underlying "unfixed-price" sales or purchases of cash commodities.[4] Fundamentally, as the Commission has observed, "context is essential to determining the nature of any price risk that has been realized and could support the existence of a bona fide hedge. . . ."[5]

As an example of a bona fide hedge of index price risk, consider a market participant who enters into contracts to sell natural gas in Appalachia priced at the Dominion South Point index price because it is unable to locate a fixed price buyer. Although the market participant will be able to sell "at market," it is exposed to the very real risk that the ultimate market price may be below its cost. Such a market participant might want to hedge its risk that the index price will fall below the cost of production, and it could appropriately do so by entering into futures transactions that effectively fix the price of natural gas.[6] Using derivatives to "fix" index prices is textbook risk management and has been commonplace in the commodities industry for many years.[7]

Similarly, it can also be economically appropriate to change the level or type of unfixed price risk to which a market participant is exposed. For example, some NGSA members may prefer to hedge the risk associated with certain daily index prices with derivative contracts that shift their floating price exposure from such daily index prices to the more stable and predictable first-of-month price under the NYMEX Henry Hub Natural Gas core referenced futures contract.

However, neither of the standard risk management techniques described above would be recognized as bona fide hedges if index price risk is ignored in the final rule. These examples illustrate why Congress's "economically appropriate" standard should not be artificially narrowed by CFTC interpretations that would impose a new, non-statutory condition onto bona fide hedging positions. To the extent that the Commission might be concerned about manipulation associated with the hedging of index price risk, such concern would be more appropriately addressed through the Commission's anti-manipulation authority, as opposed to using the bona fide hedging process.[8] Accordingly, the Commission should not prejudge index transactions as being

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[4] *See* ICE Energy Spot Month Exemption Request Form § 6.c, *available at* https://www.theice.com/publicdocs/otc/advisory_notices/IFUS_Energy_Position_Limit_Exemption_Form.doc.

[5] Supplemental Proposal at 38468 (emphasis added).

[6] This would most likely be accomplished by using Henry Hub futures contracts to fix the price of natural gas and basis futures to fix the differential between Henry Hub and Dominion South Point prices.

[7] A natural gas consumer (for example, a manufacturer) faces an analogous risk— if it buys index-price natural gas, and such price increases unexpectedly, such price increase may cause cost of the goods that it manufactures to exceed the price at which its goods can be sold. Again, this risk can be managed with derivatives if the "economically appropriate" test is not limited to "fixed price" risks.

[8] *See* Supplemental Proposal at 38465 (expressly recognizing that "a market participant's compliance with position limits or an exemption does not confer any type of safe harbor or good faith defense to a claim that the market participant had engaged in an attempted manipulation, a perfected manipulation or deceptive conduct"); *see also id.* at 38469 n.122.

inappropriate for bona fide hedge treatment but should rather explicitly recognize in its guidance provided with any new final rule on position limits that index price transactions can be appropriate for the bona fide hedging exemption.

2. *The Commission's "Substantially Related" Test for Cross-Commodity Hedges Should Not Be Interpreted So Narrowly as to Prevent Recognition of Economically Appropriate Hedges.*

The Commission should revise its guidance regarding its proposed "substantially related" test for cross-commodity hedges to avoid an interpretation that might otherwise exclude cross commodity hedges that satisfy the statutory "economically appropriate" standard. The Commission introduced its "substantially related" test in the Proposed Rule by requiring that fluctuations in the value of any bona fide hedging contract be "substantially related" to the fluctuations in the value of the hedged position. While NCGA and NGSA agree that the "substantially related" test can provide helpful guidance as to whether a cross-commodity hedge is economically appropriate for purposes of the bona fide hedging definition, the Commission should at least identify that a NEBFH exemption can be recognized if a hedge position does not satisfy the CFTC's "substantially related" test but is nonetheless "economically appropriate" given the context of the hedge.[9] In many circumstances, perfect or near-perfect hedges just aren't practically available, and cross-commodity hedges should rightfully be considered "economically appropriate." If these hedges were not economically appropriate, they would not be commonly relied upon by market participants.

As an example, a natural gas derivatives position can be an economically appropriate hedge of power price risk where power derivatives are not readily available, and they are, in fact, regularly used by market participants for this purpose. As explained in detail in NGSA's February 10, 2014 comments on the Proposed Rule,[10] the Commission's suggestion that hedges of electricity prices using Henry Hub natural gas derivatives fail to satisfy the "substantially related" test[11] is overbroad and fails to consider liquidity costs and potential differences in correlation across different time periods and geographical locations. Over some time periods and across some geographical locations, a hedge of electricity prices using a derivatives contract linked to Henry Hub may, in fact, be economically appropriate. The Commission's suggested numerical test (80% correlation for a time period of at least 36 months),[12] however, is inappropriate because it fails to take these and other contextual items (such as availability, or lack thereof, of alternative hedges) into account. For these reasons, the

[9] As the Commission has observed, ''context is essential to determining the nature of any price risk that has been realized and could support the existence of a bona fide hedge." Supplemental Proposal at 38468.

[10] *See also* NGSA's June 26, 2014 comments on the Proposed Rule. In these previously filed comments on the Proposed Rule, NGSA also identified why hedging exposures to liquefied natural gas (LNG) and "heat rate" power sales should not be considered cross-commodity hedging, which remain to be addressed by the Commission.

[11] Proposed Rule at 75717.

[12] Proposed Rule at 75717.

Commission should revise its guidance regarding cross-commodity hedges to recognize that derivatives positions taken in natural gas to hedge power price risk can satisfy its "substantially related" test for the enumerated bona fide hedging position ("EBFH") exemption or at least be "economically appropriate" for purposes of the NEBFH exemption.

B. The Commission Should Eliminate the "Five-Day Rule," Which Would Otherwise Require Early Liquidation of Anticipatory, Cross-Commodity, and Other Hedges.

The Commission should eliminate the "five-day rule" from its regulatory definition of "bona fide hedging position," which would otherwise require early liquidation of anticipatory hedges, cross-commodity hedges, and other hedges. Paragraphs 4 and 5 of the definition provide for recognition of such hedges as EBFHs, provided that "no such position is maintained in any physical delivery commodity derivative contract during the lesser of the last five days of trading or the time period for the spot month in such physical-delivery contract" (referred to herein as the "expiry period"). However, such forced liquidation would threaten to leave market participants exposed during the expiry period and risks distorting market efficiency because the divestiture would be driven by regulatory requirements, instead of market signals. By contrast, allowing parties to maintain their hedge positions during the expiry period improves liquidity during such period. Again, to the extent that the CFTC might be concerned about manipulation during the expiry period, such concern would be more appropriately addressed through the Commission's anti-manipulation authority, as opposed to using the bona fide hedge exemption process.[13] Additionally, the issue of physical supply adequacy at expiry is one that the exchanges have experience addressing effectively—for example, by allowing hedge exemptions that decrease in size over the expiry period. The need for a new, rigid, “one-size-fits-all” approach that limits the hedging ability of market participants and risks market distortions has not been demonstrated. Therefore, the five-day rule should be removed from any new final rule on position limits.

Alternatively, if the five-day rule remains a condition of the enumerated anticipatory and cross-commodity hedges, the Commission should provide explicit guidance that such hedges could still be recognized as NEBFHs by exchanges without requiring liquidation prior to the expiry period. Similar hedges are allowed under current exchange rules, such as under the "risk management position" provisions of Chicago Mercantile Exchange ("CME") Rule 559.B. To the extent that CFTC is concerned about convergence or possible distortion of prices within the expiry period, the Commission can provide guidance regarding such risks in its final rule, although the exchanges are already cognizant of such risks and police market participants' positions at expiry accordingly. As the Commission recognized in the Supplemental Proposal, exchanges have strong reputational and economic incentives to protect market participants potentially affected by recognition of an applicant's bona fide hedging position from any

[13] *See supra* note 8.

related harm and to deter such applicant from trading in a manner that might cause adverse price impacts to the market.[14]

C. The Commission Should Revise the Pass-Through Provisions in Its Definition of "Bona Fide Hedging Position" to Accommodate Secondary Pass-Through Transactions Within a Corporate Organization.

The Commission should broaden the pass-through provisions in its definition of "bona fide hedging position" to accommodate secondary pass-through transactions among affiliates within a corporate organization, to allow market participants to make the most efficient and effective use of their existing corporate structures. As the Commission has recognized, some market participants have subsidiaries that make outward facing transactions with customers but then channel such transactions through centralized derivatives trading or financing affiliates.[15] The Commission's proposed pass-through provisions appropriately recognize the offsetting of positions via pass-through hedges but place an unwarranted limitation on such offsets by not allowing market participants to fully "pass through" such positions within their own corporate organization. While this issue is most significant for large market participants, a well-functioning hedge exemption must function equally well for both large and small market participants to facilitate market liquidity and hedging efficiency.

Therefore, NCGA and NGSA request that the Commission accommodate market participants with such corporate structures by making the following changes to Section 2(ii) of the definition of "bona fide hedging position":

> "(ii)(A) Pass-through swap offsets. Such position (a pass-through swap offset) reduces risks attendant to a position resulting from a pass-through swap in the same physical commodity that was executed opposite a counterparty for which either of the following is true (a pass-through swap counterparty): (1) such pass-through swap~~the~~ position at the time of the transaction would qualify as a bona fide hedging position for such counterparty pursuant to paragraph (2)(i) of this definition ~~(a pass-through swap counterparty)~~, or (2) such pass-through swap position at the time of the transaction would qualify as a bona fide hedging position for such counterparty pursuant to this paragraph (2)(ii) and such counterparty controls, is controlled by, or is under common control with the person executing such pass-through swap offset opposite such counterparty, ~~provided that no such risk-reducing position is maintained in any physical-delivery commodity derivative contract during the lesser of the last five days of trading or the time period for the spot month in such physical-delivery commodity derivative contract~~; and

[14] Supplemental Proposal at 38488-89.

[15] CFTC No-Action Letter No. 14-144 (Nov. 26, 2014), No-Action Relief from the Clearing Requirement for Swaps Entered into by Eligible Treasury Affiliates.

> (B) Pass-through swaps. Such swap position (a pass-through swap) was executed opposite a pass-through swap counterparty and to the extent such swap position has been offset pursuant to paragraph (2)(ii)(A) of this definition."

III. The Commission Should Make Certain Modifications to Its Requirements for the Application Processes for Exchange Recognition of Bona Fide Hedging Positions to Ensure that the Exemptions are Practically Available to Market Participants.

The Supplemental Proposal provides a workable basic structure for exchanges to provide application processes for recognition of bona fide hedging positions, but certain modifications are needed to ensure that the exemption is available to market participants on a practical basis and accommodates the capital efficiencies that stem from portfolio hedging. It is critically important that the application process itself not be so burdensome or time-consuming as to render the hedge exemption useless to many market participants. As proposed, the viability of bona fide hedge exemption is at risk.

A. The Commission Should Give Exchanges Flexibility to Administer Hedge Exemptions with respect to Federal Limits in the Same Proven Manner as They Currently Administer Exemptions from Exchange-Set Limits.

NCGA and NGSA generally support the Commission's provision for application processes by which the exchanges can recognize NEBFHs, EBFHs, and exemption of various spread positions. As the Commission recognizes, the exchanges have well-developed practices and substantial expertise with respect to administration of such exemptions, and such practices and expertise should be leveraged to avoid the need to invent new procedures.[16] NCGA and NGSA members have substantial experience using such processes provided by ICE and CME and believe that they work well—accommodating market participants' needs for flexibility, expediency, and predictability, all while consistently maintaining the integrity of the limits. Therefore, as a general matter, the Commission should, to the greatest extent possible, allow the exchanges to administer exemptions for NEBFHs, EBFHs, and spread positions in the same manner as they have been to date.

B. The Commission Must Eliminate Unnecessary Compliance Requirements Associated with Application for Exchange Recognition of Bona Fide Hedging Positions to Ensure that Recognition of Such Positions Can Be Obtained in a Timely Manner.

To maintain the practical benefit of the bona fide hedge exemption, it is essential that exemption applications be acted upon in a timely manner. Importantly, the

[16] Supplemental Proposal at 38488.

Commission recognizes the importance of upholding "the general principle of timely administration of the application process" in the Supplemental Proposal. In this regard, NCGA and NGSA agree that "the individual exchanges themselves are in the best position to evaluate how quickly each can administer the application process, in order best to accommodate the needs of market participants."[17] Under current administration, NGSA members have found that they can typically obtain hedge exemptions within one business day to one week of submitting an application, depending on the complexity of the applicable position and details of the application. NCGA and NGSA members have found the exchanges to be responsive and reasonable in administration of the existing application processes and believe that turnaround times have generally been reasonable and acceptable.

To ensure the continued efficiency of the exemption application processes, the Commission should not impose new undue burdens on either market participants or the exchanges. In this regard, NGSA believes that the Commission's proposed requirement under Section 150.9(a)(3)(iv) that applicants provide "[d]etailed information regarding the applicant's activity in the cash markets for the commodity . . . during the past three years" in connection with any application for a NEBFH is unnecessary and unduly burdensome. Current practices by the exchanges typically only require applicants to provide such data for the preceding year, though the market participant requesting the hedge exemption must stand ready to provide further supporting documentation for the requested exemption on request. Collecting three years of data as a baseline requirement for any hedge would be burdensome both on market participants (to collect, organize, and submit such data) and on exchanges (to review it). Accordingly, NCGA and NGSA believe it would be more appropriate to allow exchanges to determine on a case-by-case basis whether information from a period longer than one year is necessary to verify the appropriateness of recognizing a particular NEBFH. Under the Commission's proposed Sections 150.9(a)(3)(v) and (a)(4)(ii), the exchanges would already have sufficient authority and guidance to do so. Accordingly, NCGA and NGSA request that the Commission revise Section 150.9(a)(3)(iv) of the Supplemental Proposal to require applicants to provide the specified data for the past one year as opposed to three years.

C. The Commission Should Allow Exchanges to Provide a Mechanism for Retroactive Recognition of Bona Fide Hedging Positions to Accommodate Sudden and Unforeseen Hedging Needs.

NCGA and NGSA also request that the Commission allow exchanges to recognize a bona fide hedge exemption for up to a five-day retroactive period in circumstances where market participants need to exceed limits to address a sudden and unforeseen hedging need. CME and ICE currently provide mechanisms for such recognition,[18] which are used infrequently but are nonetheless important. Market participants operating in a dynamic market with a large book and complex positions can

[17] Supplemental Proposal at 38473.

[18] *See* CME Rule 559, available at http://www.cmegroup.com/rulebook/CME/I/5/5.pdf; ICE Rule 6.13(c), available at https://www.theice.com/publicdocs/rulebooks/futures_us/6_Regulatory.pdf.

sometimes find themselves in a circumstance where they have a sudden and unforeseen need to exceed a limit in order to reasonably hedge their risks. The Commission's final rule on position limits should allow exchanges to continue to recognize such hedges as bona fide hedges provided that they meet the statutory requirements and are applied for no later than five days after a position limit exceedance.

To ensure that such allowances will not diminish the overall integrity of the process, two effective safeguards under the current exchange-administered processes could continue to be required. First, the exchange rules could continue to require market participants making use of the retroactive application to demonstrate that the applied-for hedge was required to address a sudden and unforeseen hedging need. In this regard, NCGA and NGSA note that it would be difficult to show that a hedging need was sudden and unforeseen if a market participant used the emergency hedging mechanism on more than an infrequent basis. Second, if the emergency hedge recognition is not granted, the exchange rules could continue to require the applicant to immediately unwind its position and also to deem the applicant to have been in violation for any period in which its position exceeded the applicable limits. In light of such requirements, market participants would continue to have a strong incentive to apply for any exchange recognition of hedge positions in advance, so as to obtain a determination beforehand and avoid the risk of being found in violation and having to pay related fines or suffer other related penalties.

It is also important to note that the requested retroactive application mechanism would not expand in any way what is properly a "bona fide hedging position" for purposes of the Congressional standard. Rather, it would merely adapt the process for recognition of a bona fide hedging position to better accommodate the realities of complex dynamic markets. For these reasons, NCGA and NGSA request that the Commission allow exchanges to recognize a bona fide hedge exemption for up to a five-day retroactive period in circumstances where market participants need to exceed limits to address a sudden an unforeseen hedging need.

D. The Commission Must Ensure That the Reporting Requirements Associated with Recognition of Bona Fide Hedging Positions Are Manageable.

The reporting requirements associated with the processes for exchange recognition of bona fide hedging positions must not create compliance burdens or risks that are unmanageable, overly time-consuming, or costly to the point that they deter use of such hedges, which would increase market participant's commercial risk and damage market liquidity. Accordingly, such reporting requirements should be streamlined as much as possible, and duplicative requirements to report to both the Commission and the exchanges should be eliminated (or at least conformed so that identical reports or report elements can be provided to each as much as possible). In particular, NCGA and NGSA questions whether exchanges will have access to enough data (*e.g.*, regarding positions on other exchanges, over-the-counter, or in the cash commodity) to make meaningful use of the applicant reports that would be required under the Supplemental Proposal.

It is illustrative to summarize here the CFTC reporting requirements under the Proposed Rule and exchange reporting requirements under the Supplemental Proposal with which market participants would have to comply:

- Under Part 19 of the Proposed Rule, market participants making use of the bona fide hedge exemption would be required to file with the Commission: (i) monthly series '04 reports with respect to most bona fide hedging positions and (ii) daily reports during the spot period for any positions making use of the "conditional spot month limit" with respect to special commodities designated by the Commission.[19]

- Under Section 150.7(d), (e), (f), and (g) of the Proposed Rule, market participants making use of the bona fide hedge exemption with respect to anticipatory hedge positions would be required to file with the Commission: (i) an initial report for any such position, (ii) an update prior to exceeding the amount provided for in its most recent filing, and (iii) additional updates on annual and monthly bases.

- Under Section 150.9(a)(6) of the Supplemental Proposal, an exchange would have to file new rules requiring an applicant to: (i) file a report with such exchange whenever such applicant owns or controls a position that such exchange has recognized as a NEBFH, (ii) report the offsetting cash positions, and (iii) update and maintain the accuracy of any such report.

- Under Section 150.11 of the Supplemental Proposal, an exchange would have to file new rules requiring an applicant to: (i) file a report with the Commission pursuant to Section 150.7, and a copy with the applicable exchange, whenever such applicant owns or controls a position that such exchange has recognized as an EBFH, (ii) report the offsetting cash positions, and (iii) update and maintain the accuracy of any such report.

The Commission's proposed mechanism for reporting EBFHs recognized by exchanges would utilize the process established under the Proposed Rule for reporting such positions to the Commission, with an identical copy to be filed with the applicable exchange(s). NCGA and NGSA believe that a similar process should be used with respect to reporting of NEBFHs, such that the NEBFH would be reported to the Commission under Part 19 and a copy of such report would be filed with the applicable exchange. The Commission should eliminate any requirements in Section 150.9(a)(6) of the Supplemental Proposal that would require additional reporting to the exchanges.

Any additional reporting requirements should be left to the discretion of the exchanges, which are in the best position to judge the value of any increased reporting. In this respect, NCGA and NGSA members believe that exchange reporting requirements

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[19] *See* Proposed Rule at §§ 19.00(a), 19.01(b)(1)-(2), 19.03.

should not require market participants to file reports more frequently than monthly. Daily or even weekly reporting requirements would create barriers that could hamper liquidity and price discovery by discouraging market participants, including many smaller market participants who may not find it cost-effective to implement new technologies required to address such frequent reporting, from making beneficial use of the bona fide hedge exemptions. However, if necessary, the daily reporting could be implemented in a limited scope as a means of allowing market participants to hold hedge exemptions through the expiry period as an alternative to the five-day rule.

To summarize, for the above reasons, NCGA and NGSA request that the Commission revise its proposed reporting requirements in Section 150.9(a)(6) of the Supplemental Proposal and provide further guidance as appropriate in any final rule to implement exchange reporting requirements consistent with these considerations. Much like the Commission's guidance for the large trader reports, a "user's manual" for the position limits reports would facilitate market participant compliance and, accordingly NCGA and NGSA also request that the Commission develop such a manual for position limits reports.

E. The Commission Should Provide Further Guidance to Clarify that Revocation of Hedge Exemptions Should Be Rare and that Reduction of Positions or Other Actions to Come Into Compliance After Such Revocation May Require More Than One Business Day.

The revocation of a recognized bona fide hedge position should be an extremely rare occurrence, and, consistent with existing exchange rules, such revocation (as well as any modification that would reduce the allowed size of a position) should only be allowed "for cause."[20] In the event that a bona fide hedge exemption is revoked by either the Commission or an exchange, market participants must have a commercially reasonable amount of time to reduce their position or otherwise come into compliance. The Commission recognizes as much in the Supplemental Proposal but NCGA and NGSA are concerned about the Commission's suggestion that, "generally, it 'believes such time period would be less than one business day.'"[21]

However, as the Commission indicated in the Supplemental Proposal, the Commission and exchanges must adequately consider factors "such as current market conditions and the protection of price discovery in the market" in imposing any unwind requirements.[22] Exchanges recognize that a commercially reasonable amount time in a liquid market will be much quicker than in an illiquid market. Unwinding a position quickly in an illiquid market, such as in many non-spot month contracts, could create a significant market disruption. Therefore, the CFTC should acknowledge in its final rule that in some circumstances, the required unwind time may need to be significantly longer than one business day.

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[20] *See, e.g.*, CME Rule 559(6).
[21] Supplemental Proposal at 38476 n. 168 (quoting Proposed Rule at 75713).
[22] Supplemental Proposal at 38476.

F. The Quarterly Publication of Newly Recognized NEBFHs Must Adequately Preserve Trading Anonymity.

NCGA and NGSA agree that quarterly publication of summaries describing the types of positions for which NEBFH exemptions were recognized, with accompanying explanations of the reasons such recognition was granted, would provide helpful transparency to market participants. Such publication should "alert similarly situated market participants to the possibility of receiving recognition of a NEBFH," who could then use such information to "help evaluate whether to apply for recognition of a NEBFH."[23] However, as the Commission implicitly recognized in the Supplemental Proposal, trading anonymity should be preserved to avoid deterring efficient market transactions.[24] As the U.S. Department of Justice commented in past FERC proceedings regarding transparency of natural gas markets, revealing confidential data can make markets inefficient by facilitating coordination.[25] Accordingly, NCGA and NGSA request that the Commission explicitly provide in Rule 150.9(a)(7) that the summaries must be published "in a manner that preserves the anonymity of the applicant" and provide additional guidance regarding the types of sensitive items that should be omitted from any summary, such as the size of the position(s) taken or to be taken by the applicant or the delivery point(s) or other information that might identify the applicant.

CONCLUSION

NCGA and NGSA welcome the opportunity to further discuss these comments with the Commission. Correspondence regarding this submission should be directed to:

Sam Willett
Senior Director of Public Policy
National Corn Growers Association
Washington DC Office
122 C Street NW, Suite 510
Washington, DC 20001-2109
202-628-7001
e-mail: willett@dc.ncga.com

Jennifer Fordham
Senior Vice President, Government Affairs
Natural Gas Supply Association
1620 Eye Street, NW, Suite 700
Washington, DC 20006
Direct: 202-326-9317
e-mail: jfordham@ngsa.org

If we can provide any additional information, please do not hesitate to contact us.

Respectfully submitted,

National Corn Growers Association
Natural Gas Supply Association

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[23] Supplemental Proposal at 38476.

[24] Supplemental Proposal at 38473.

[25] Comments of the U.S. Department of Justice 4-6, *Enhanced Natural Gas Market Transparency*, FERC Docket No. RM13-1-000 (Feb. 1, 2013); Comments of the U.S. Department of Justice 4-7, *Transparency Provisions of the Energy Policy Act of 2005*, FERC Docket No. AD06-11-000 (Jan. 25, 2007).