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July 13, 2016

VIA ONLINE SUBMISSION

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

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

Dear Mr. Kirkpatrick:

CME Group Inc. ("CME Group")[1] appreciates this opportunity to provide comments on the Commodity Futures Trading Commission's ("CFTC" or "Commission") supplemental notice of proposed rulemaking regarding "Position Limits for Derivatives: Certain Exemptions and Guidance" ("Supplemental Proposal").[2] Since the Commission proposed in 2013 to expand federal position limits to cover futures contracts on 28 physical commodities as well as economically-equivalent swaps ("2013 Proposal"[3] and, collectively with the Supplemental Proposal and complementary proposed rules on aggregation of positions,[4] the "Overall Proposal"), CME Group has provided multiple comment letters and participated in several public roundtables on position limits.[5] We appreciate that the Commission has considered certain of our suggestions, as evidenced by the Supplemental Proposal's inclusion of the concept of

1 CME Group is the parent of four U.S.-based designated contract markets ("DCMs"): Chicago Mercantile Exchange Inc. ("CME"), Board of Trade of the City of Chicago, Inc. ("CBOT"), New York Mercantile Exchange, Inc. ("NYMEX") and the Commodity Exchange, Inc. ("COMEX") (collectively, the "CME Group Exchanges" or "Exchanges"). These Exchanges offer a wide range of products available across all major asset classes, including: futures and options based on interest rates, equity indexes, foreign exchange, energy, metals, and agricultural commodities. The CME Group's Exchanges serve the hedging, risk management and trading needs of our global customer base by facilitating transactions through the CME Globex® electronic trading platform, our open outcry trading facilities in New York and Chicago, as well as through privately negotiated transactions. CME Group also operates CME Clearing, a derivatives clearing organization which provides clearing and settlement services for exchange-traded and over-the-counter derivatives transactions as well as a swap execution facility ("SEF").

2 *See* Position Limits for Derivatives: Certain Exemptions and Guidance, 81 Fed. Reg. 38458 (June 13, 2016).

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

4 *See* Aggregation of Positions, 78 Fed. Reg. 68946 (Nov. 15, 2013) (Notice of Proposed Rulemaking); Aggregation of Positions, 80 Fed. Reg. 58365 (Sept. 29, 2015) (Supplemental Notice of Proposed Rulemaking).

5 Please refer to CME Group's past comments letters regarding the 2013 Proposal and related public roundtables for additional detail on our concerns with the Commission's proposed framework.

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exchange-administered non-enumerated bona fide hedge ("NEBFH") and spread exemptions. However, we maintain that the Overall Proposal is ill-conceived as a matter of law and ill-advised as a matter of regulatory policy. This letter will first underscore some critical flaws of the 2013 Proposal which are perpetuated by the Supplemental Proposal, and will then identify our particular concerns with the Supplemental Proposal. CME Group urges the Commission to *not* adopt the Overall Proposal as it is not in accordance with law and would work to the detriment of price discovery as well as hedgers and all other participants in our markets.

I. FLAWS OF THE OVERALL PROPOSAL

As discussed extensively in CME Group's comment letter on the 2013 Proposal, the Commission has failed to abide by its statutory authority to establish federal position limits *only* as "necessary" and "appropriate."[6] The result is a position limit framework that is arbitrary and capricious and not in accordance with law: the Overall Proposal would effectuate unduly high federal spot-month position limits that increase the risk of burdensome "excessive speculation" that the Commission claims to be preventing, and would impose wholly unnecessary non-spot-month federal position limits that threaten to diminish efficient price discovery. CME Group would support the imposition of federal *spot-month* limits that are set at appropriate levels without favoring cash-settled contracts, as discussed below, provided that the Commission makes the statutorily-required commodity-by-commodity necessity findings for the 28 physical commodities subject to its Overall Proposal.[7] Based on experience setting and administering spot-month limits at the exchange level, CME Group believes that the Commission could make such necessity findings for its proposed federal spot-month limits, but the Commission has not done so. Rather, the Commission has broadly asserted that position limits are a "reasonable means" of addressing burdens on interstate commerce and has relied heavily on two case studies that are outdated and each limited to a single commodity market (natural gas and silver).[8] CME Group does not believe that the Commission could make the requisite necessity finding with respect to federal *non-spot-month* limits because flexible position accountability levels have long served as and are an effective alternative to hard limits outside the spot month.[9]

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[6] *See* Letter from CME Group to CFTC re Position Limits for Derivatives (RIN 3038-AD99), dated February 10, 2014, at 5-19 ("2013 Comment Letter"), *available at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=59718&SearchText= (providing a comprehensive discussion of how the 2013 Proposal is not in accordance with law).

[7] Pursuant to CEA section 4a(a)(1), the Commission must find that position limits are "necessary" to address unreasonable price fluctuations or changes caused by excessive speculation in a given commodity. *See* 2013 Comment Letter, *supra* note 6, at 12-13.

[8] *See* 2013 Proposal, 78 Fed. Reg. at 75683 n. 34, 75685-96.

[9] Exchanges have a long history of administering position accountability levels outside of the spot month, and this experience would support the imposition of federal non-spot-month accountability levels to address inter-exchange or cross-market surveillance concerns. Moreover, Congress essentially endorsed position accountability levels as an alternative to position limits in the Commodity Futures Modernization Act of 2000 ("CFMA"). Specifically, the CFMA added section 5(d)(5) to the CEA, allowing DCMs to impose, as is necessary and appropriate, position limits or position accountability for speculators. Dodd-Frank did not eliminate or reduce the availability of position accountability in any way.

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In addition to its failure to comply with the "necessity" finding requirement, the Commission has disregarded or misapplied the "appropriateness" standards in CEA section 4a(a)(3)(B),[10] thereby creating a proposed position limit framework that would endanger price discovery and market integrity overall. CME Group is particularly concerned by the Commission's inappropriate and arbitrary favoring of cash-settled contracts to the detriment of physically-delivered benchmark futures contracts. For instance, the proposed five-day rule would essentially disallow some of the most common bona fide hedge exemptions for *physically-delivered* contract positions in the spot month (or in the last five days or trading, whichever is shorter). The five-day rule therefore encourages the migration of spot-month liquidity away from the physically-delivered contract and to look-a-like cash-settled futures (and swaps). By undermining liquidity in benchmark physically-delivered futures contracts, the five-day rule will disrupt the price discovery function of those contracts.[11] This result is contrary to the express intent of Congress in CEA section 4a(a)(3)(B), which directs the CFTC in exercising its position limit authority to "ensure that the price discovery function of the underlying market is not disrupted." Without ensuring, "to the maximum extent practicable," that such objective is achieved, the Commission will have failed to develop an "appropriate" position limit framework.

Like the five-day rule, the CFTC's proposed conditional spot-month limits for cash-settled contracts that are a multiple of the limit for the underlying physical-delivery contracts ("conditional limit") would vitiate the statutory touchstones that Congress set forth for an "appropriate" position limits framework. As a preliminary matter, we note that—even absent a conditional limit—the CFTC's proposed ceiling for spot-month limits (i.e., 25 percent of estimated deliverable supply) could yield an excessively high limit when accurate, up-to-date deliverable supply estimates are used.[12] CME Group believes that the 25 percent spot-month limit formula is thus not appropriately calibrated to achieve the statutory objective of "diminish[ing], eliminat[ing], or prevent[ing] excessive speculation [causing sudden or unreasonable fluctuations or unwarranted changes in price]."[13] As CME Group stated in a prior comment letter, the Commission should not adopt the 25 percent formula as a "one-size-fits all" approach, but rather should work with those DCMs listing benchmark physical delivery contracts to set federal limits below the 25 percent ceiling where appropriate and should ensure that the

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[10] The "appropriateness" standards function as safeguards to further constrain the CFTC's position limit authority and include the following: (i) diminish, eliminate, or prevent excessive speculation causing sudden or unreasonable fluctuations or unwarranted changes in price; (ii) deter and prevent market manipulation, squeezes, and corners; (iii) ensure sufficient liquidity for bona fide hedgers; and (iv) ensure that the price discovery of the underlying market is not disrupted. *See* CEA section 4a(a)(3)(B).

[11] As CME Group further observed in its comment letter on the 2013 Proposal, the shift of liquidity away from benchmark physically-delivered futures contracts and to related cash-settled substitutes would also impair price convergence between the futures and cash markets. Unlike physically-delivered futures contracts, cash-settled contracts have no ability to serve as substitutes for a physical commodity position and are thus less likely to converge with the cash market. Ultimately, the compromising of price convergence disrupts the price discovery process. *See* 2013 Comment Letter, *supra* note 6, at 25-26.

[12] For example, if the 25 percent formula is applied to the most recent deliverable supply estimate for WTI crude oil submitted by CME Group to the Commission in 2015, the federal spot-month limit for the physically-delivered benchmark futures contract would be approximately 10,400—a more than three times increase from the current exchange spot-month limit of 3,000. Such a result cannot be what Congress intended.

[13] CEA section 4a(a)(3)(B)(i).

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same federal limit is applied to physically-delivered and cash-settled contracts based on the same underlying physical commodity.[14]

The proposed conditional limit magnifies the issues presented by the 25 percent ceiling, and introduces other concerns, by allowing a speculator to hold a cash-settled position in the spot month of up to *five times* of, or *125 percent* of, estimated deliverable supply. Because a condition of this limit is *not* holding a spot-month position in the related physically-delivered referenced contract, the conditional limit operates to drain liquidity from that physically-delivered contract. As is the case with the five-day rule, this liquidity drain would prevent physical delivery markets from serving the price discovery function that they have long provided and that Congress plainly sought to preserve in CEA section 4a(a)(3)(B)(iv). The loss of essential market liquidity would also harm hedgers (and ultimately consumers) in contravention of CEA section 4a(a)(3)(B)(iii).

That the conditional limit is not "appropriate" per the Congressional standards is most evident in light of the increased potential for price manipulation and distortions. More specifically, though prohibiting the holding of a physically-delivered referenced contract position in the same underlying commodity, the conditional limit would allow for the holding of an *unlimited* amount of the actual physical commodity.[15] Because actual physical commodity markets are linked to physically-delivered contracts, a trader availing himself of the conditional limit and holding an uncapped physical commodity position would still be able to manipulate physically-delivered contract prices. Price distortions in the physically-delivered contract would, in turn, be transmitted to the linked cash-settled contract in which the trader holds a leveraged five-times position.[16] The Commission's conditional limit proposal thus does not preclude distortions in the physically-delivered contract, but actually incentivizes and enables a trader qualifying for the conditional limit to manipulate the cash commodity market (and related physically-delivered contract) in order to benefit the trader's leveraged cash-settled contract position.[17] This result clearly runs afoul of the statutory "appropriateness" standards, and the

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14 *See* Letter from CME Group to CFTC re Position Limits for Derivatives (RIN 3038-AD99) and Aggregation of Positions (RIN 3038-AD82), dated January 22, 2015, at 4-5, *available at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=60307&SearchText=CME.

15 Notably, under the CFTC's vacated Part 151 rules, a trader claiming the conditional limit for cash-settled contracts could hold only a limited amount of the actual physical commodity (i.e., no more than 25 percent of estimated deliverable supply).

16 In the Commission's October 2007 "Report on the Oversight of Trading on Regulated Futures Exchanges and Exempt Commercial Markets" ("October 2007 Report"), the Commission recognized the linked nature of physically-delivered and cash-settled contract markets. Specifically, the Commission stated that the NYMEX physically-delivered natural gas futures contract and the ICE cash-settled natural gas contract are "essentially a single market" for natural gas derivatives trading. October 2007 Report, *available at* http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/pr5403-07_ecmreport.pdf; *see also* Jeffrey H. Harris, Commodity Futures Trading Commission, Chief Economist, Testimony at Hearing to Examine Trading on Regulated Exchanges and Exempt Commercial Markets (Sept. 18, 2007), http://www.cftc.gov/ucm/groups/public/@newsroom/documents/speechandtestimony/ opaharris_091807.pdf (referring to economic data showing that the NYMEX physically-delivered natural gas futures contract and the ICE cash-settled natural gas contract each serve a price-leading function from time to time).

17 This type of manipulative scheme (i.e., manipulation of cash market to benefit cash-settled derivatives position) has been alleged by the CFTC in a number of cases. *See, e.g.*, *In re Total Gas & Power North America, Inc.*, *et al.*, CFTC Docket No. 16-03 (Dec. 7, 2015) (Order Instituting Proceedings Pursuant to Sections 6(c) and 6(d) of the Commodity Exchange Act, Making Findings and Imposing Remedial Sanctions); *In re Dairy Farmers of*

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Proposal's only attempt to address this increased risk of price manipulation is to impose certain reporting obligations solely on natural gas traders claiming the conditional limit.[18]

Ultimately, the Overall Proposal cannot be adopted with its legal deficiencies and adverse policy implications discussed above and further identified in Part II below.[19] If the Commission were to finalize the Overall Proposal as is, it would not only be contravening the CEA but would also be imperiling the markets and market participants by detrimentally affecting liquidity in physically-delivered benchmark futures contracts, especially in the spot month.

II. CONCERNS WITH THE SUPPLEMENTAL PROPOSAL

In addition to retaining certain aspects of the 2013 Proposal that we find concerning (see II.A. below), the Supplemental Proposal adds a number of provisions relating to exchange-administered processes for position limit exemptions. As demonstrated in II.B and II.C below, the new proposed requirements are fraught with ambiguity and oversights. In order to abide by its Administrative Procedure Act ("APA") duty to afford an opportunity for "meaningful and informed comment," the Commission must issue a re-proposal to "make its views known to the public *in a concrete and focused form*."[20] If the Commission ultimately adopts a rule that leaves interested parties in a position where "they would have [] to divine [the Commission's] unspoken thoughts," then the Commission's rule would be vulnerable to an APA challenge.[21] CME Group

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America, Inc., et al., CFTC Docket No. 09-02 (Dec. 16, 2008) (Order Instituting Proceeding Pursuant to Sections 6(c) and 6(d) of the Commodity Exchange Act, Making Findings and Imposing Remedial Sanctions); *CFTC v. Delay*, 2006 WL 3359076 (D. Neb. Nov. 17, 2006). The Commission cannot have it both ways, disregarding the risk of manipulation when it comes to excessively high position limits for cash-settled contracts (futures and swaps) but bringing enforcement cases for the same type of manipulative activity.

[18] As CME Group pointed out in its comment letter on the 2013 Proposal, the extent to which such reporting requirements would be helpful in detecting manipulation in the natural gas market is also questionable given that the requirements would apply to a trader claiming the conditional limit but not the trader's cash market colluders who would go undetected. *See* 2013 Comment Letter, *supra* note 6, at 33.

[19] For further discussion of the 2013 Proposal's failure to abide by the CEA's "appropriateness" standards, see 2013 Comment Letter, *supra* note 6, at 19-74.

[20] *See Home Box Office, Inc. v. FCC*, 567 F.2d 9, 36 (D.C. Cir. 1977).

[21] *See Int'l Union, United Mine Workers of Am. v. Mine Safety & Health Admin*, 407 F.3d 1250, 1259-60 (D.C. Cir. 2005) (stating that a final rule is not a "logical outgrowth" of a proposed rule and thus violates the APA's notice-and-comment requirement where "interested parties would have had to 'divine [the agency's] unspoken thoughts,' because the final rule was surprisingly distant from the proposed rule") (internal citations omitted); *see also CSX Transp., Inc. v. Surface Transp. Bd.*, 584 F.3d 1076, 1081-83 (D.C. Cir. 2009) (holding that provisions of the agency's final rule, though not constituting a "complete turnaround from the NPRM," had failed the "logical outgrowth" test because the agency had not expressly asked for comments on particular issues raised by such provisions or otherwise made clear that the agency was contemplating such changes to the NPRM); *Shell Oil v. EPA*, 950 F.2d 741, 751-52 (D.C. Cir. 1992) (vacating provisions of the agency's final rule on the grounds that such provisions were not a "logical outgrowth" of the agency's rule proposal because such provisions had no counterpart in the proposal and represented a "marked" change in emphasis in regulatory strategy and because the agency only gave "weak signals" of making such a change to its proposal, thereby depriving commenters of an "opportunity to anticipate or criticize the [final] rules or offer alternatives"); *Chocolate Mfrs. Ass'n v. Block*, 755 F.2d 1098, 1104 (4th Cir. 1985) ("An agency . . . does not have carte blanche to establish a rule contrary to its original proposal simply because it receives suggestions to alter it during the comment period. An interested party must have been alerted by the notice to the possibility of the changes eventually adopted from the comments.").

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therefore urges the Commission to re-propose certain provisions of the Supplemental Proposal in such a manner that provides the necessary clarifications and modifications identified in our comments below.

A. Enumerated Bona Fide Hedging: Five-Day Rule

CME Group is troubled that the Supplemental Proposal retains the five-day rule, notwithstanding widespread, economically-validated objections. We continue to believe that the five-day rule is not a necessary or appropriate restriction on any exemption. To the extent that the five-day rule stems from the Commission's concerns about "protecting the price discovery process in the core referenced futures contracts, particularly as those contracts approach expiration,"[22] those concerns are already addressed through the Core Principle 4 obligations of DCMs and SEFs (collectively, "exchanges"). Under Core Principle 4, an exchange is required to "prevent manipulation, price distortion, and disruptions of the delivery or cash-settlement process through market surveillance, compliance, and enforcement practices and procedures."[23] This core principle obligation therefore renders the five-day rule unnecessary by ensuring that an exchange could not recognize a position limit exemption that would lead to manipulation, distortion, or disruption of physical delivery or cash-settlement processes. As evidenced in staff's Rule Enforcement Reviews, CME Group Exchanges have a proven track record of fulfilling their Core Principle 4 obligations when it comes to implementing position limit rules. CME Group once again urges the Commission to remove the unnecessary five-day rule from enumerated hedging categories.[24]

If the Commission insists on keeping the five-day rule, then such rule should apply equally to positions in physically-delivered and cash-settled contracts.[25] The Commission has failed to explain why its concerns with respect to physical delivery contracts would not arise with respect to cash-settled contracts. In particular, the Commission glosses over the potential for manipulation, distortion, or disruption of *cash-settlement* processes during the last five trading days (or spot month) in the cash-settled contract. Ultimately, and as we discuss further below, for any five-day rule that is retained, exchanges should be allowed to use the NEBFH application process to recognize positions in the last five trading days (or spot month) for enumerated strategies that are otherwise subject to the five-day rule.

[22] Supplemental Proposal, 81 Fed. Reg. at 38478.

[23] CEA section 5(d)(4) ("DCM Core Principle 4"); CEA section 5h(f)(3) ("SEF Core Principle 4").

[24] In response to the Commission's request for comment, we ask that the Commission not extend the 5-day rule to spreads/cash and carry trade exemptions recognized pursuant to proposed section 150.10 or NEBFH exemptions recognized pursuant to proposed section 150.9.

[25] Additionally, the Commission should clarify that market participants need not treat as enumerated cross-commodity hedges those strategies where a cash position being hedged involves the "same cash commodity" as the commodity underlying the futures contract, despite the cash commodity not being deliverable against the contract. For example, certain grades of crude oil and blends are not deliverable against CME's WTI contract, but nonetheless are commonly and effectively hedged using the WTI contract. These non-deliverable grades and blends of crude oil still should be considered the "same cash commodity" for purposes of the cross-commodity hedge definition in proposed section 150.1. Hedging strategies for different grades and blends of WTI using the WTI contract therefore could be considered enumerated hedges of inventory or cash commodity purchase/sales contracts that are not subject to the 5-day rule.

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B. Exchange-Administered Exemptions

CME Group appreciates the Commission having accepted our suggestion to allow exchanges to grant certain exemptions from position limits. As proposed, regulations 150.9, 150.10, and 150.11 would establish similar processes through which market participants could request, and exchanges could recognize, exemptions from federal limits for NEBFH positions, spread positions, and enumerated anticipatory bona fide hedge positions (collectively, "exchange-administered exemptions"). CME Group remains concerned, however, that both substantive and procedural aspects of the Supplemental Proposal would serve to greatly restrict the utility of exchange-administered exemptions to the detriment of legitimate risk management strategies that Congress intended to allow.[26]

1. The Commission must provide additional guidance regarding the scope of exchange-administered exemptions for NEBFH positions.

CME Group supports the Supplemental Proposal's allowance for exchange-administered NEBFH exemptions on the basis that exchanges have a "close knowledge of trading activity on [their] facilit[ies]" and "experience and expertise . . . in administering their own processes for recognition of bona fide hedging positions under current § 1.3(z)."[27] Any meaningful exchange-administered exemption process must give exchanges full discretion to grant an exemption; otherwise it is an exemption process in name only and a waste of exchange resources. The Commission must therefore clarify the scope of discretion exchanges may exercise in recognizing NEBFH positions before the Commission will take action to overturn an exchange determination.

In particular, the Commission has left unclear whether exclusion of a particular strategy from the list of enumerated bona fide hedges in proposed section 150.1 forecloses an exchange from recognizing an NEBFH position for such strategy pursuant to proposed section 150.9. For example, the Commission declined to recognize as enumerated hedges certain of the strategies described in the petition from the Commercial Energy Working Group ("CEWG").[28] As stated in prior comment letters, CME Group historically has viewed those CEWG strategies excluded by the Commission to be legitimate hedges.[29] If the Commission intends for there to be a presumption that such non-enumerated strategies cannot meet the statutory and proposed regulatory standards as an exchange-recognized NEBFH position, then the Commission has done nothing to address commenters' concerns that the 2013 Proposal would greatly diminish the ability of commercial end-users to serve their legitimate hedging needs.[30] Moreover, this

[26] *See generally* CEA section 4a(a)(3)(B)(iii) (requiring that CFTC-set position limits not restrict the ability of hedgers to manage risk).

[27] *See* Supplemental Proposal, 81 Fed. Reg. at 38466 (internal quotations omitted).

[28] *See* 2013 Proposal, 78 Fed. Reg. at 75719-23.

[29] *See* 2013 Comment Letter, *supra* note 6, at 55-59.

[30] Footnote 140 of the Supplemental Proposal adopting release is particularly troubling. Exchanges are referred to "the Commission's relevant regulations and interpretations" in determining whether an NEBFH position meets the standards in CEA section 4a(c)(2), unless "confront[ed] [with] novel facts and circumstances with respect to a particular applicant's position, dissimilar to facts and circumstances *previously considered by the Commission*. In [those] cases, an exchange may request assistance from the Commission." *See* Supplemental Proposal, 81

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approach would make the NEBFH exemption process unworkable for exchanges to administer, as it would substitute the Commission's judgment for that of the very entities that the Commission has recognized as expert.

We therefore urge the Commission to clarify that exchanges would be able to use their discretion to recognize an NEBFH position for a strategy that has otherwise been excluded from the list of enumerated bona fide hedges. Such an approach would be consistent with current practice wherein exchanges' experience and expertise historically have been un-encumbered by the Commission pre-judging any market participant's NEBFH application to the exchange. Indeed, by drawing upon its close knowledge of trading activity on its market, an exchange is in the best position to determine that a particular set of facts and circumstances satisfies the statutory and proposed regulatory standards for bona fide hedge exemptions.

A prime example of where exchanges should be able to use their discretion is in recognizing as NEBFHs during the last five days of trading in the underlying referenced contract those enumerated strategies that would otherwise be subject to the five-day rule. Under the current federal position limit regime for the eight core agricultural contracts, the Commission has reserved authority in existing section 1.3(z)(3) to grant such NEBFH exemptions for positions held in the last five days of trading.[31] The very existence of this authority is an explicit acknowledgment by the Commission that certain facts and circumstances could warrant recognizing an NEBFH position in the last five trading days for an enumerated strategy that is otherwise subject to the five-day rule. The Commission has not sufficiently justified why those same facts and circumstances could not exist today with respect to referenced contracts. Simply suggesting that market participants have not demonstrated a historical need to hold a position in physical delivery referenced contracts in excess of spot month limits is not a reasoned basis for declining to extend existing section 1.3(z)(3) authority to exchanges in connection with recognizing NEBFHs pursuant to proposed section 150.9.[32] Moreover, the Commission's claims regarding historical spot-month exemption usage are simply incorrect. CME Group Exchanges have decades of hedge exemption records that document numerous market participants, particularly in energy markets, having held positions of varying sizes above the relevant limit into the spot month in reliance upon an exemption. Furthermore, the fact that the Supplemental Proposal would apply the five-day rule to enumerated strategies for physically-delivered contracts, but not cash-settled contracts, underscores the need for exchanges to be able to recognize an NEBFH in the last five trading days for an enumerated strategy that is otherwise subject to the five-day rule.

2. The application requirements for exchange-administered exemptions must be streamlined and clarified.

Fed. Reg. at 38472 n.140 (emphasis added). If exchanges may only recognize NEBFH positions that have been pre-approved by the Commission, then the utility of proposed regulation 150.9 is greatly diminished.

[31] *See* Definition of Bona Fide Hedging and Related Reporting Requirements, 42 Fed. Reg. 42748, 42749-50 ("[P]ersons wishing to exceed [federal speculative limits] during the five last trading days may submit materials [to the CFTC] supporting classification of the position as bona fide hedging pursuant to [§ 1.3(z)(3)].").

[32] *See* 2013 Proposal, 78 Fed. Reg. at 75710-11, 75723.

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The Supplemental Proposal would require applicants for NEBFH exemptions to demonstrate a position's compliance with CEA section 4a(c) by providing "[d]etailed information" on the position, including data regarding cash-market activity in the underlying commodity for the past three years.[33] Exchange-recognized spread exemption applicants would be required to submit "detailed information" demonstrating why a spread position "would further the purposes of section 4a(a)(3)(B) of the [CEA]."[34] It is unclear why an exchange needs "detailed information," aside from limited historical exposure data, to determine whether a position complies with the relevant statutory and proposed regulatory standards for the requested exemption.

CME Group Exchanges have a long history of considering applications for position limit exemptions and have found that the most recent year of cash market exposure data is sufficient to guide the exchange's analysis of whether a position would meet the relevant legal criteria for the requested exemption. Should additional historical cash market data be needed to make a final determination, the Exchanges' rulebooks provide authority to request such information.[35] Additionally, CME Group Exchanges have never required applicants to provide detailed legal or economic analyses demonstrating a position's compliance with statutory and regulatory standards. Rather, an applicant must explain its strategy, which the Exchange will consider in light of its expertise with the relevant market in performing its own legal and economic analysis. Requiring an exemption applicant to hire outside counsel to provide a legal analysis could be cost prohibitive as well as impractical from a timing perspective due to many market participants' need to employ trading strategies in real time. Moreover, exchanges still would be obligated under the Supplemental Proposal to perform their own analyses of the position's compliance with statutory and proposed regulatory standards.[36] It is unclear whether an exchange could disagree with an applicant's analysis but nonetheless grant an exemption based on its own analysis showing that the position complies with the relevant standards. CME Group urges the Commission to either abandon this unnecessary requirement altogether, or re-propose the requirement and explain why it is a necessary shift in light of historical exchange precedent.

3. The reporting requirements for exchange-administered exemptions must be streamlined and clarified.

If granted, exchange-administered exemptions trigger ongoing reporting requirements for exemption recipients to the exchanges and for the exchanges to the Commission. CME

[33] *See* proposed § 150.9(a)(3)(iv).

[34] *See* proposed § 150.10(a)(3)(ii).

[35] For existing market participants who have applied for exemptions under the current position limit regime, exchanges already may have cash market data covering the past three years. At a minimum, the Commission should allow exchanges to utilize existing historical data as opposed to requiring that data be re-submitted.

[36] In considering spread positions, the Supplemental Proposal requires exchanges to balance the need to ensure sufficient market liquidity for bona fide hedgers, "to the maximum extent practicable," against the other statutory purposes of position limits enumerated in CEA section 4a(a)(3)(B). *See* proposed § 150.10(a)(4)(vi). Accordingly, the Commission must recognize that an exchange can only determine that recognizing a spread position is *likely* to "ensure sufficient liquidity for bona fide hedgers" while *likely* not "unreasonably reduc[ing] the effectiveness of position limits."

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Group requests that the Commission clarify and justify certain aspects relating to mechanics and content of the proposed reporting requirements.

Utility of exemption recipient reports. While we appreciate that the Commission's oversight of exchange-administered exemptions may require access to exposure data that supports exchange-administered exemptions currently being used (i.e., offsetting cash positions or spread components),[37] we believe requiring real-time exemption recipient reports containing such information to be of limited value relative to the administrative burdens that would be placed on both the exemption recipient and the exchange. Therefore, CME Group urges the Commission to remove the exemption recipient reporting requirement altogether and allow exchanges to continue their current practices for information-gathering and surveillance of exemption recipients. Exchanges have a long history of administering position limit exemptions that recognize a host of underlying exposures. Those exposures for a particular commodity could consist of, for example, fixed-price, basis, and arbitrage components. Many commercial end users, however, hedge on a portfolio basis using both enumerated and non-enumerated strategies, and do not have a pre-existing business need to differentiate between strategies when putting on a position. To comply with the Supplement Proposal's requirement to silo various exposures into separate reports, commercial end users therefore would need to implement costly changes to their position tracking and reporting systems capable of generating updates each day as the totality of exposures fluctuates.[38]

Moreover, exchanges would become inundated with unnecessary reports that provide an incomplete picture of exposure and have never before been required to meet Core Principle 4 obligations with respect to monitoring for compliance with position limits. Rather, exchanges routinely conduct surveillance by communicating with exemption recipients regarding their underlying exposure and evaluating both the economic rationale and liquidation strategies for the position. In many instances, a variety of different underlying exposures may support a participant's position exceeding a limit, including exposure for purposes of an enumerated exemption that would not be conveyed to an exchange through the proposed exemption recipient reports. We believe an exchange should continue using existing authority to inquire, on an as-needed basis, about the totality of exposures underlying positions on its markets in

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[37] *See* proposed §§ 150.9(a)(6), 150.9(c)(2), 150.10(a)(6), 150.10(c)(2), 150.11(a)(6). If the Commission adopts the exemption recipient reporting requirements despite the policy concerns described above, then the Commission must clarify several ambiguities that exist in the Supplemental Proposal's regulatory text. It is unclear whether a position is established for purposes of triggering these reporting requirements when the exemption recipient first establishes a position on the exchange in excess of the federal limit, or when the recipient establishes an aggregate position in excess of the federal limit through combined exchange and OTC positions. Moreover, the Supplemental Proposal does not address how these reporting requirements should apply when an exchange sets its position limit for a referenced contract lower than the applicable federal limit. In such a scenario, it is not clear whether reporting would be triggered when the market participant exceeds the exchange limit or the federal limit in reliance upon an exemption.

[38] Exemption recipients would be required "to update and maintain the accuracy of any such report" provided to the exchange upon establishing the exempt position. *See, e.g.*, proposed § 150.9(a)(6). It is unclear what types of events would trigger the need for exemption recipients to provide to the exchange (and the exchange to provide to the Commission) an update to the initial report filed, particularly in light of the Commission's alternative proposals to require NEBFH and spread exemption recipients to submit Form 504 reports to the exchange during the last five days of trading in the underlying contract. *See* Supplemental Proposal, 81 Fed. Reg. at 38471, 38478. For example, the Commission should clarify whether an update is required when an exposure changes but the size of the position does not, or when a position is no longer utilized.

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order to monitor for compliance with position limits. Furthermore, the Commission has not sufficiently justified its sudden need to receive real-time, continuous exposure data reports that it never before has received in performing oversight of exchange-administered exemptions.[39]

Content of weekly exchange reports to the Commission and quarterly website updates. The Commission should clarify that the proposed weekly reporting requirements for exchanges only require providing to the Commission the most essential information regarding exchange-administered exemptions recognized or granted during the prior week that the Commission needs to perform its oversight role.[40] For example, CME Group Exchanges currently create internal summary documents for all exemption applications received that provide basic information regarding the applicant and a summary of the Exchange's calculations relevant to underlying exposure. CME Group would support providing those documents to the Commission each week. If more detailed information or additional explanation is needed for the Commission to complete its review of an exemption, the Commission can request such information from the exchange pursuant to existing authority. Similarly, quarterly website summaries of exemptions granted or recognized should remain high-level. Exchanges should not be required to disclose any conditions of an exemption granted due to the potential for such information to compromise the exemption recipient's position. Exchanges also should not be required to disclose their internal analyses performed in granting any exemption.[41]

4. Application of exchange-administered NEBFH exemptions to OTC positions must be clarified.

The Commission must clarify an exchange's obligation with respect to recognizing and monitoring NEBFH exemptions for OTC positions. The Commission explains in the preamble to the Supplemental Proposal that it intends for the NEBFH recognition process under proposed section 150.9 to be available to market participants requesting exemptions for OTC positions.[42] However, the rule text of proposed section 150.9(a) makes no reference to OTC positions, and instead contemplates an exchange recognizing NEBFH exemptions only in referenced contracts listed by the exchange for which it sets position limits. Not only do exchanges not list OTC contracts, but the Supplemental Proposal would provide certain exchanges with relief from the 2013 Proposal's requirement to establish and monitor compliance with exchange-set limits for OTC positions.[43] The pre-requisites for recognizing NEBFH positions in proposed section

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[39] If the exemption recipient reporting requirement is not removed altogether, the Commission should at least not require exchanges to act as intermediaries between exemption recipients and the CFTC with respect to reports concerning the establishment of exempt position and underlying exposures that exchanges do not want or need. Similar to other Series '04 reports (both current and proposed), the Commission should require exemption recipients to provide any underlying exposure information directly to the CFTC.

[40] *See* proposed §§ 150.9(c)(1), 150.10(c)(1).

[41] *See, e.g.*, proposed § 150.9(a)(7).

[42] *See* Supplemental Proposal, 81 Fed. Reg. at 38471.

[43] *See* Supplemental Proposal, 81 Fed. Reg. at 38459-62. While the Supplemental Proposal suggests that an exchange need only list a referenced contract in commodity "X" in order to recognize NEBFH positions for other referenced contracts in commodity X, it is unclear whether those other referenced contracts still must be listed on the exchange (regardless of the one-year requirement), or could be OTC contracts instead. *See* Supplemental Proposal, 81 Fed. Reg. at 38471 n.131.

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150.9(a) are thus directly at odds with the Commission's proposed relief for exchanges from administering position limits for OTC positions. CME Group questions how exchanges could monitor OTC positions for compliance with NEBFH exemptions pursuant to the process in proposed section 150.9(a), particularly in light of the Commission's acknowledgement that exchanges lack visibility into OTC markets. Without further clarification through a re-proposal as to the Commission's intent, CME Group cannot provide meaningful comment on the feasibility of administering NEBFH exemptions for OTC positions.

5. Retroactive exchange-administered exemptions should be allowed.

The Supplemental Proposal requires that applications for exchange-administered exemptions be filed *in advance* of the date on which limits would be exceeded.[44] Neither the preamble nor rule text of the Supplemental Proposal addresses the possibility of granting an exchange-administered exemption retroactively, which exchanges are permitted to do today. CME Group believes that retroactive exchange-administered exemptions have proven to be a workable and sound policy, are consistent with the CEA, and thus should be permitted to continue absent the Commission providing any rationale for the Supplemental Proposal's abrupt departure from longstanding policy upon which the industry has come to rely.[45]

In our experience, the need for a retroactive exchange-administered exemption may arise when a market participant needs to establish a position in excess of a position limit in the spot month but does not have time to seek advance approval under Exchange rules due to the need to trade in real time.[46] In such cases, the Exchange will grant the requested exemption retroactively, provided that the market participant's position otherwise satisfies the relevant statutory criteria and the application is filed within the time period prescribed under Exchange rules.[47] If the Exchange determines that the retroactive exemption is not warranted, then the market participant who applied retroactively would be subject to a position limit violation. In our experience, the prospect of having an application denied and being found in violation of position limits has worked to deter market participants from attempting to exploit the retroactive exemption process.

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[44] *See* proposed §§ 150.9(a)(4), 150.10(a)(4), 150.11(a)(3).

[45] When an agency, without stating a reason, departs radically from prior policy upon which its industry relied, that departure is arbitrary and capricious under the APA and not entitled to *Chevron* deference. *See Encino Motorcars, LLC v. Navarro et. al*, 579 U.S. _ (2016); *see also Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 41-42 (1983) ("an agency changing its course by rescinding a rule is obligated to supply a reasoned analysis for the change beyond that which may be required when an agency does not act in the first instance"); *W. States Petroleum Ass'n v. EPA*, 87 F.3d 280, 284 (9th Cir. 1996) (stating that an agency "must clearly set forth the ground for its departure from prior norms").

[46] As an example, without the ability to apply for an exemption retroactively, a participant who sees a disconnect between either the cash markets or pricing relationships between spreads both intermarket or intramarket would be handcuffed from executing that trade until an application was filed and approved. As a result, the markets may not converge as quickly as they otherwise would under the look-back exemption regime in place today.

[47] CME Group Exchange rules provide that market participants have up to five business days after establishing an exemption-eligible position in excess of the relevant limit to submit an application. *See, e.g.*, NYMEX Rule 559. In 2015, CME Group Exchanges approved 68 exemptions from position limits after an overage of the relevant limit already had occurred.

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Retroactive exchange-administered exemptions are also in accordance with the statute. CEA section 4a(c)(1) states that no CFTC position limit rule applies to "transactions or positions which *are shown to be* bona fide hedging transactions or positions" (emphasis added). The phrase "shown to be" is flexible enough to encompass retroactive or "look back" exemptions. Given the breadth of the statutory language and the policy basis noted above, in addition to the lack of any stated rationale to change longstanding policy, CME Group urges the Commission to continue to allow for retroactive exchange-administered exemptions.

6. Pre-requisites for processing exchange-administered exemptions should be revised to eliminate the "actively traded" requirement and to clarify that the 1-year "experience and expertise" requirement is based on asset class.

CME Group believes that certain prerequisites for processing exchange-administered exemptions are too stringent and should be eliminated or modified. In particular, the Commission has proposed that, for an exchange to be eligible to process exchange-administered exemptions for a commodity derivative contract, the commodity derivative contract must be "actively traded" on the exchange and be subject to exchange position limits for at least one year. The Commission seems to contend that if an exchange does not meet these requirements, the exchange "may not be familiar enough with the specific needs and differing practices of the commercial market participants in those markets," "might not be incentivized to protect or manage the relevant commodity market," and would lack a "minimum level of expertise gained in monitoring futures or swaps trading in a particular physical commodity."[48] CME Group strongly disagrees with these views.

An exchange will have familiarity with its commodity markets and an incentive to protect such markets even absent the "actively traded" requirement. Indeed, under Core Principle 4, exchanges must "prevent manipulation, price distortion, and disruptions of the delivery or cash-settlement process through market surveillance . . ., including [] methods for conducting real-time monitoring of trading and [] comprehensive and accurate trade reconstruction."[49] Accordingly, in fulfilling this statutory core principle duty, an exchange will have developed expertise in the contracts it lists and the markets in which those contracts trade, and will have gained an understanding of related markets (e.g., markets in the same asset class). This experience and expertise that stems from a pre-existing statutory requirement renders the "actively traded" requirement wholly unnecessary.

The Supplemental Proposal itself appears to recognize that an exchange may have such experience and expertise even with respect to contracts that it does not list. Specifically, in acknowledging that certain market participants may wish to obtain an exchange-administered exemption for an OTC position, the Preamble states "exchanges that list particular referenced contracts will have enough information about the markets in which such contracts trade and will be sufficiently familiar with the specific needs and differing practices of the commercial participants in such markets in order to *knowledgably* recognize NEBFHs" for the related OTC derivative position.[50] In effect, the Commission seems to be taking the untenable position that

[48] *See* Supplemental Proposal, 81 Fed. Reg. at 38470-71, 38477.

[49] *See* CEA section 5(d)(4) (DCM Core Principle 4); CEA section 5h(f)(3) (SEF Core Principle 4).

[50] Supplemental Proposal, 81 Fed. Reg. at 38471 (emphasis added).

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an exchange has sufficient knowledge to grant exchange-administered exemptions for *unlisted* derivatives contracts, but does not have sufficient knowledge to grant such exemptions for certain *listed* contracts (e.g., contracts for which the exchange has less than a year of experience and expertise administering position limits).

CME Group believes that the Preamble's rationale for extending the exchange-administered exemption process to OTC contracts should apply with equal force to allowing an exchange to process exchange-administered exemptions for listed contracts subject to position limits for less than a year, provided that the exchange has at least a year of experience in administering position limits in similar contracts in the same asset class (e.g., base metals). The experience gained in that asset class, coupled with the exchange's trade monitoring in satisfaction of Core Principle 4, will enable the exchange to knowledgably process exemptions for the listed contract.

C. Exchange-Set Speculative Limits and Exemptions for Non-Referenced Contracts

Proposed section 150.5(b) would govern exchange-set limits and exemptions therefrom with respect to non-referenced contracts. It is difficult for CME Group to provide meaningful comment with respect to these requirements as the regulatory text is riddled with ambiguities and potential oversights. As such, the Commission should re-propose this section, clarifying its intention and addressing the points we highlight below.

The Supplemental Proposal would appear to force exchanges to break with historical practice in administering NEBFHs for non-referenced contracts by requiring exchanges to abide by the same hedge recognition processes and standards that would be applicable for referenced contracts under proposed sections 150.1 and 150.9(a).[51] As discussed above, the scope of exchange discretion under proposed section 150.9(a) is unclear. Thus, exchanges could be bound by the five-day rule in recognizing as NEBFH positions certain enumerated hedge strategies for non-referenced contracts, despite the same five-day rule limitation not applying in similar scenarios today. Under existing Part 150, exchanges are not limited to the enumerated hedge restrictions in section 1.3(z)(2) when considering whether to exempt a position outside of the eight core agricultural contracts currently subject to federal limits. As set forth in their rulebooks, CME Group Exchanges currently grant exemptions from exchange limits for positions outside of the eight core agricultural contracts that meet the criteria for bona fide hedge positions in section 1.3(z)(1), as well as exemptions for risk management and arbitrage/spread positions that do not meet the enumerated hedge criteria in section 1.3(z)(2) but otherwise meet the general definition of a bona fide hedge.[52] Staff Rule Enforcement Reviews have generally concluded that the Exchanges' hedge exemption practices are consistent with the CEA and CFTC rules. Yet, without articulating any reason for doing so, the Commission appears to contemplate an about-face in requiring the Exchanges to revise their rules in a manner that may entail applying enumerated bona fide hedge restrictions for referenced contracts to all NEBFH positions recognized, even those in non-referenced contracts.[53]

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[51] *See* proposed § 150.5(b)(5)(i) (providing that an exchange's hedge exemption rules must "provide for recognition as an [NEBFH] *in a manner consistent with the process described in § 150.9(a)*") (emphasis added).

[52] *See, e.g.*, NYMEX Rule 559.

[53] *See supra* note 45.

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Aside from restricting the types of hedge exemptions that exchanges may grant for non-referenced contracts, requiring that exchanges may only recognize NEBFHs for non-referenced contracts "in a manner consistent with the process described in § 150.9(a)" also would appear to impose new burdensome and unnecessary compliance obligations on market participants that do not exist today. In particular, the Supplemental Proposal is devoid of any explanation regarding the Commission's need to receive the same exemption reports from exchanges for non-referenced contracts that it would receive for referenced contracts. The Supplemental Proposal characterizes exchanges submitting exemption recipient reports to the CFTC as "support[ing] the Commission's surveillance program, by facilitating the tracking of NEBFHs recognized by the exchange, and helping the Commission to ensure that an applicant's activities conform to the terms of recognition that the exchange has established."[54] While the Commission has a surveillance obligation with respect to federal limits, the same obligation has never before existed with respect to exchange-set limits for non-referenced contracts, and does not exist today. The CFTC has misinterpreted its mandate and therefore should drop this unnecessary reporting requirement and related procedures with respect to non-referenced contracts.

Finally, while exchanges appear to be bound by rules applicable to referenced contracts when recognizing hedge exemptions, it is not clear how similar rules for anticipatory hedge and spread exemptions would apply. Proposed section 150.5(b) is silent with respect to anticipatory hedges contemplated under the process in proposed section 150.11,[55] and makes no reference in proposed section 150.5(b)(5)(ii)(C) to the process in proposed section 150.10 when describing spread exemptions an exchange may recognize. The Commission must clarify whether it intends that market participants and exchanges may avail themselves of such processes in applying for and recognizing exemptions from exchange limits for non-referenced contracts.

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CME Group appreciates this opportunity to comment on the Supplemental Proposal and hopes that the Commission will continue to engage with us in a dialogue on this important rulemaking. It is imperative, however, that unless the legal and policy deficiencies discussed in this letter are addressed and the Overall Proposal's favored treatment of cash-settled contracts in the spot month is abandoned, the Commission should not adopt any final rules on position limits. Please contact me with any questions or comments by telephone at (312) 930-3488 or by e-mail at Kathleen.Cronin@cmegroup.com, as well as Thomas LaSala, Managing Director, Chief Regulatory Officer, by telephone at (212) 299-2897 or by e-mail at Thomas. LaSala@cmegroup.com.

[54] *See* Supplemental Proposal, 81 Fed. Reg. at 38475.

[55] However, in its cost-benefit analysis, the Commission notes that proposed section 150.11 "works in concert with" "proposed § 150.5(b)(5), with the effect that recognized anticipatory enumerated bona fide hedge positions may exceed exchange-set position limits for contracts not subject to federal position limits." *See* Supplemental Proposal, 81 Fed. Reg. at 38495.

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