July 13, 2016

Mr. Christopher Kirkpatrick
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, NW
Washington, DC 20581

Re: Position Limits for Derivatives: Certain Exemptions and Guidance (CFTC RIN: 3038-AD99)

Dear Mr. Kirkpatrick,

Better Markets Inc.[1] appreciates the opportunity to comment again on the above-captioned proposed position limits for derivatives (Proposal, Proposed Rule), issued by the Commodity Futures Trading Commission (CFTC, Commission).

INTRODUCTION

Physical commodity producers and purchasers grow the food we eat, generate the power in our homes, manufacture the vehicles we travel in, produce the fuel we need, and otherwise directly enable not just modern life, but also a rising standard of living. It is not an overstatement to say that commodity markets are essential for every man, woman, child, and business in the United States. That is what is at stake when regulating these markets and why it is vital to regulate them properly.

Over the past two decades, commodity markets have experienced a sea change in both market structure and deregulation. As the culmination of a series of deregulatory measures that had already significantly eroded position limits and other traditional market protections, the heavily criticized 2001 Commodity Futures Modernization Act opened a Pandora's Box of deregulated derivatives trading. Since then, an incredible number of market crises have occurred in a short period of time. The Amaranth Natural gas episode in 2001, the unprecedented speculative volatility of oil prices during 2008, and numerous

[1] Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system that protects and promotes Americans' jobs, savings, retirements, and more.

other market events have illustrated the need for a new and effective regulatory structure in commodities derivatives.

Current conditions in today's commodity derivatives markets are not much better. Sustained and unprecedented volatility, decreased commercial utility, and physical price disconnection have been occurring on a routine basis and have generated immense and unnecessary costs to businesses and households. There is a clear need for swift and comprehensive regulation.

The current debate over the role of speculation in commodity markets, and the role of regulators in containing it, has been going on for nearly 100 years,[2] and the congressional mandate to prevent excessive speculation has existed for nearly as long. While the scope and degree of enforcement has varied significantly over the years, regulators have repeatedly recognized the need to limit speculative positions in response to nearly every market crisis since the 1920's. Now, in the midst of the largest sustained disruption to commodity markets in their volatile history, speculative position limits have never been more essential.

The Proposed Rule indicates the Commission's acknowledgement of the ongoing urgent need as recognized in the law, but falls short of accomplishing the intended goal of restoring and protecting the functional market utility to physical commodity producers and consumers. In a series of proposals over the years, the Commission has added qualifications and exemptions that greatly diminish the effectiveness of its approach. However, this Proposed Rule represents the most recent and most egregious undermining of Congress's language and intent and the Commission must overhaul it. The Proposed Rule impermissibly reduces the Commission's ability to regulate excessive speculation in the commodity markets by delegating some of its paramount duties to the industry's for-profit exchanges. Specifically, the Proposal purports to delegate to designated contract markets (DCM) and swap execution facilities (SEF) the authority to recognize non-enumerated bona fide hedges (NEBFH) or enumerated anticipatory bona fide hedges (ABFH), as well as well as to exempt from CFTC position limits certain spread positions. Additionally, the Proposal broadens the definition of the bona fide hedge exemption. These provisions are baseless and fundamentally at odds with the statutory mandate of limiting speculation.

The comments below will demonstrate the need for an effective position limits regime and propose changes to the Proposed Rule to accomplish that end.

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[2] On the discourse leading up to the 1936 CEA: "Like the debates throughout the 1920s, opinions sharply differed as to whether regulation could better be accomplished by the exchanges rather than by a federal agency, whether speculators were to blame for depressing grain prices, and whether the imposition of limits on speculation would impair the ability of grain merchants and others in the grain business to hedge." See Testimony of Dan M. Berkovitz "Position Limits and the Hedge Exemption, Brief Legislative History"(Jul.28, 2009), available at http://www.cftc.gov/PressRoom/SpeechesTestimony/berkovitzstatement072809#P19_5690.

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DISCUSSION

As has been exhaustively demonstrated by numerous academic studies and compelling data set forth in previous letters to the CFTC,[3] excessive speculation is a serious threat to the core function of our commodity markets. The CFTC should fulfill the statutory mandate to strengthen regulation of speculation, not weaken it, as this Proposed Rule dramatically does. The Commission must take concrete steps to remediate these weaknesses to provide strong, comprehensive, and effective Position Limits Rules, as Congress has explicitly directed it to do.

The Commission Must Craft a Rule that Achieves All of Congress' Goals

For nearly 150 years, commodity futures markets have existed to serve two major functions: 1) offsetting the price risk of physical market exposures, and 2) facilitating price discovery for commodity market participants. Congress has enshrined these objectives in the law since the 1936 passage of the Commodity Exchange act, and the CFTC in particular has been directed to preserve these functions since its creation in 1974.[4]

In amendments to the Commodity Exchange Act in the Dodd-Frank Act, the Commission has been specifically mandated to impose speculative position limits to achieve four distinct and separate goals:

(i) to diminish, eliminate, or prevent excessive speculation;
(ii) to deter and prevent market manipulation, squeezes, and corners;
(iii) to ensure sufficient market liquidity for bona fide hedgers; and
(iv) to ensure that the price discovery function of the underlying market is not disrupted.[5]

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[3] See Better Markets letter to CFTC dated March 28, 2011 ("Position Limits Comment Letter 2011"), at pages 80-85, available at http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=34010&SearchText=better%20markets (incorporated herein as though fully set forth); see also Better Markets letter on Position Limits to CFTC dated February 10, 2014 ("Position Limits Comment Letter 2014") available at http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=59716 and Better Markets letter on Position Limits to CFTC dated February 10, 2014 ("Aggregation Comment Letter 2014") available at http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=59715; see also David Frenk & Wallace Turbeville, Commodity Index Traders and the Boom/Bust Cycle in Commodities Prices, (Oct. 14, 2011), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1945570. For a list of further studies, all of which are incorporated herein as if fully set forth, see http://www2.weedonline.org/uploads/evidence_on_impact_of_commodity_speculation.pdf.

[4] "Through effective oversight, the CFTC enables the futures markets to serve the important function of providing a means for price discovery and offsetting price risk." CFTC Mission Statement http://www.cftc.gov/about/missionresponsibilities/index.htm.

[5] CEA section 4a(a)(3); 7 U.S.C. 6a(a)(3).

It is clear from these explicit criteria that Congress sees four distinct threats to commodities markets, and that each is to be addressed in the comprehensive imposition of position limits by the CFTC.

Under the most basic and longstanding rules of statutory construction, such a clear and straightforward enumeration cannot be interpreted to suggest that satisfying one would necessarily satisfy another. Moreover, satisfying one cannot deem others superfluous. For example, there is no basis to believe that the promotion of liquidity alone would also prevent market manipulation. Protecting liquidity for hedgers and preventing market manipulation are distinct and equally important Congressionally mandated goals expressly set forth in the statute. Proposing a regime that achieves one while disregarding the others is an inappropriate failure to satisfy the unambiguous direction of Congress. Indeed, it would be an abdication of regulatory responsibility and a violation of the law to pick and choose some but not all Congressional directives.

The Proposal which grants the exchanges the capacity to grant NEBFHs, ABFHs and spread exemptions, and expands the bona fide hedge definition does nothing to diminish, eliminate, or prevent excessive speculation, which is the first priority for the CFTC under the Dodd-Frank Act. Judged by this standard, the Proposed Rule is largely a failure. The Proposal also falls short of accomplishing two of the other stated objectives in the Dodd-Frank Act: deterring and preventing market manipulation, squeezes, and corners; and ensuring price discovery. Specifically, the Commission has taken great lengths to describe, set, and justify a delegation of its authority and a process for exchanges to grant exemptions that exclusively aims to enhance liquidity, while failing to address the probable outcome of decreased market integrity that would result in excessive speculation, market manipulation, counterproductive increased volume instead of liquidity, or impaired price discovery.

The Commission, and not the exchanges, is most fit to appropriately and comprehensively monitor the participants in these markets to ensure that non-commercial participants do not cause excessive speculation, damaging the utility of the commodity markets for those who need them. The Commission has access to the complete commodity derivatives markets, in sharp contrast to the exchanges that only have access to relatively small parts of the markets. As a result, a Commission administered process is the only one that will cover the entire markets and provide broad and uniform regulation.

Furthermore, exchanges are for-profit entities and naturally compete with one another. Thus, if the Proposal is adopted, as is, market participants, particularly buy-side firms, will face negative anticompetitive effects between exchanges, or exchanges and SEFs. This is already a major area of concern in the SEF space, as all SEF's are not treated equally – particularly, by the major swaps dealer banks. Indeed, under this Proposal, the Commission would not be able to achieve its intended "fair and open access" goal in market participants' NEBFH recognition.

From a practical implementation standpoint, requiring the exchanges to recognize NEBFH's and the Commission serving merely as the second line of review, would be

inappropriate for the following reasons. First, market participants would likely migrate to the exchanges that tend to be more lenient in recognizing NEBFHs, which would cause a race to the bottom for exemption recognition while simultaneously reducing market integrity. Second, as stated above, the exchanges do not have a complete picture of the market, so they cannot properly see the impact of a hedge on the commodity markets in totality.

For all these reasons, only the Commission, rather than the exchanges, is capable of satisfying the four Dodd-Frank Act objectives enumerated above.

Bona Fide Hedges Should Be linked to Demonstrable Physical Positions

The primary goal of a position limits regime is the restriction of excessive speculative activity by non-commercial interests to protect the utility and, indeed, the viability of the market for genuine and legitimate commercial interests. Therefore, exemptions must be provided only to those who can demonstrate physical positions, and therefore the specific need to hedge.

To this end, the CFTC has gone to great lengths to carefully consider and enumerate an array of circumstances under which activity in the futures market is a legitimate offset for the risks incurred in the physical market. However, the Commission's attempts to address and accommodate the complexity and variety of legitimate hedging strategies present evermore opportunities for evasion.

The 2013 Position Limits Proposal included these two requirements: 1) that a market participant establish and liquidate a bona fide hedge in an "orderly manner;" and 2) risks offset by a commodity derivative contract be "incidental" to the position holder's commercial operations. The CFTC proposes to eliminate these two obligations in the Proposal, explaining that it is not aware of a denial of a bona fide hedge due to a lack of orderly trading on the exchange.

Any amendment to the bona fide hedge determination process must include an effort to remediate an enormous flaw in the Proposed Rule, which effectively allows financial hedges for commodity index funds to avail themselves of bona fide hedge exemptions. The financial risk management activities of swap dealers should not be considered bona fide hedges, and the requirement that such hedges be substantiated by activity in the physical market (not by offsetting positions in swaps) would work to remedy this troubling loophole.[6]

Indeed, the fundamental objective of position limits is to restrain speculative activity that is unrelated to hedging of physical commodities. Swap dealers, financial

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[6] On its own, this kind of hedge determination process would not remedy the inappropriate exclusion of the futures trades that facilitate commodity index funds from position limits. A complete remedy would require additional changes to the proposed Aggregation rule to prevent the netting of swaps and futures positions, as we suggested in the February 10, 2014 Position Limits Letter and February 10, 2014 Aggregation Letter.

derivative offsets, and purely speculative market participants should be universally subject to strict, comprehensive limits.

While there is merit to the concerns of legitimate end-users, who are frustrated with the prospect of retrofitting their activities, it is important to remember that these rules are in place precisely to protect their interests. The overwhelming influence of unbridled excessive speculation have hijacked these important markets, most notably in 2008, and will likely do so again without proper regulation and then oversight.

There Should Be No Delay in Implementing Position Limits for Swaps

Under the Proposal, the Commission will temporarily delay for exchanges that lack access to "sufficient swap position information" (SSPI) the requirement to establish and monitor position limits on swaps. According to the Proposal, an exchange has access to SSPI if it:

> "(1) It had access to daily information about its market participants' open swap positions; or
> (2) it knows that its market participants regularly engage on its exchange in large volumes of speculative trading activity (it may gain that knowledge through surveillance of heavy trading activity), that would cause reasonable surveillance personnel at an exchange to inquire further about a market participant's intentions and total open swap positions."[7]

Much has been made of the fact that data on swaps and swaptions will not be fully available for some time for the exchanges, and it has been argued from some corners that this is a reason to delay implementing position limits. On the other hand, the Commission already has access to this data. Therefore, this is another reason exchanges are ill-equipped to grant exemptions.

Additionally, regulation of excessive speculation in the swaps market should mirror the futures markets rules. Swaps markets generally reference futures markets for pricing. Moreover, activity in swaps affects prices. Position limits for swaps, aimed at curbing excessive speculation in the swaps markets will reduce costs for bona-fide hedgers. There is therefore neither a reason nor a justification for the Commission to delay implementing position limits on the swaps markets.

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[7] Proposed Rule Pg 38460-38461.

CONCLUSION

There is simply no valid reason for the Commission to weaken its 2013 Position Limits Proposal. It has a clear statutory mandate in Dodd Frank and the CEA to end excessive speculation. The integrity of the markets and the fortunes of Americas producers and purchasers -- genuine end-users -- depend on these markets and the Commission, not the for profit exchanges, must enact a Proposed Rule that fully implements the law. Thus, the Commission must overhaul the Proposal as detailed above.

We hope these comments are helpful.

Sincerely,

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