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February 28, 2017

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, 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") reproposal regarding "Position Limits for Derivatives" ("Reproposal"), 81 Fed. Reg. 96704 (Dec. 30, 2016).

Starting even before the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") was passed, the Commission has devoted extensive resources to the analysis of the role of speculation in physical commodity markets and whether or how it should be limited. CME Group appreciates the Commission's commitment and dedication to these endeavors; however, we remain concerned that certain key components regarding operation of the markets may not have been given consistent recognition. Speculation provides essential liquidity that leads to better pricing for hedgers and better price discovery for all. Limiting economic forces that provide these benefits should be undertaken only when, and to the extent, necessary.

[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 Chicago, as well as through privately negotiated transactions. CME Group also operates CME Clearing, a derivatives clearing organization ("DCO") which provides clearing and settlement services for exchange-traded and over-the-counter derivatives transactions as well as a swap execution facility ("SEF").

Unfortunately, the Reproposal does not follow this course and continues to be predicated on flawed legal determinations. First, the CFTC claims that Congress mandated physical commodity position limits in the Dodd-Frank amendments it made to Section 4a of the Commodity Exchange Act ("CEA"). Second, the Commission asserts that, even if not mandated, physical commodity position limits are generally necessary to diminish, eliminate or prevent the burdens of excessive speculation under Section 4a(a)(1) of the CEA. As we have stated in prior comment letters, CME Group believes that both determinations are in error.[2] In our view, the Commission may statutorily proceed to adopt federal position limits only when it finds that such limits are necessary for particular commodity markets in accordance with Section 4a(a)(1). The Reproposal never does this. In the Appendix to this letter, we have included a complete statement of our legal views with emphasis on our response to any new arguments the Commission makes in the Reproposal.

CME Group is also concerned that, if the Commission were to impose position limits, its reproposed federal position limit regime would harm market liquidity and market integrity as well as the interests of commercial end-users and those who rely on our markets' price discovery. To avoid these adverse consequences, CME Group believes that the following substantive revisions must be made:

- The general definition of bona fide hedging and the Reproposal's list of enumerated hedging categories must be broadened to ensure that commercials and other market participants will be able to conduct all of their customary hedging activities with certainty and without interruption.

- The provisions allowing DCMs and SEFs (collectively, "exchanges") to grant non-enumerated hedge exemptions must be clarified to facilitate the processing of such exemptions and effectuate fully the salutary benefits of empowering exchanges to provide this service to market participants.

- The five-day rule should be eliminated, which would avoid arbitrary favorable treatment for cash-settled contracts over physically-delivered contracts; such arbitrary treatment would contravene market integrity and fair competition.

- Any federal spot-month limits should be set at levels recommended by the exchange listing the physically-delivered benchmark contract, including (but not limited to) CME's recommended spot-month limit levels in RBOB, Crude Oil, and ULSD.

- Spot-month limit parity should be adopted as the standard for all physically-delivered benchmark contracts and their cash-settled counterparts. The Commission should not allow either a much higher conditional cash-settled spot-month limit for Natural Gas or higher, exchange-imposed conditional cash-settled spot-month limits for non-referenced contract markets.

[2] *See* Letter from CME Group to CFTC re Position Limits for Derivatives (RIN 3038-AD99), dated February 10, 2014, at 5-19 ("2014 Comment Letter"), *available at* https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=59718&SearchText=cme; Letter from CME Group to CFTC re Position Limits for Derivatives: Certain Exemptions and Guidance (RIN 3038-AD99), dated July 13, 2016, at 2 ("2016 Comment Letter"), *available at* https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=60926&SearchText=cme.

- Federal non-spot-month limits should not be adopted in the initial phase of any new federal position limit regime that the Commission implements; rather, the Commission should defer action on federal non-spot-month limits until it first determines the effectiveness of (i) any federal limits imposed in the spot month and (ii) the exchanges' non-spot-month accountability levels.

In the balance of this letter, we discuss our specific concerns with substantive aspects of the Reproposal's federal limit regime and elaborate on our recommendations. We also include a request for the CFTC to confirm our understanding of a particular federal aggregation rule that would apply to exchange-set limits under the Reproposal.

I. REPROPOSAL'S BONA FIDE HEDGING DEFINITION AND EXCHANGE-ADMINISTERED EXEMPTION PROCESS

CME Group believes that the Reproposal contains an unduly narrow definition of bona fide hedging. This definition (along with the CFTC's interpretation) would not seem to cover all reasonable commercial risks (only price risks), would arbitrarily constrain hedging in physically-delivered contracts, and would fail to recognize legitimate risk-reducing strategies as enumerated bona fide hedges. Faced with limited availability of enumerated hedges, commercial market participants would increasingly have to turn to the proposed exchange-administered exemption process for non-enumerated bona fide hedge ("NEBFH") exemptions. Unlike an enumerated exemption, an NEBFH exemption would present uncertainty for market participants (and exchanges) given that the CFTC may decide to overturn an exchange's recognition of NEBFH transactions or positions. To be clear, CME Group does support an exchange-administered process for federal limit exemptions, but urges the Commission to make the process more workable by bringing it more in line with current exchange practice, to the extent practicable. The foregoing concerns and specific recommendations are discussed further below.

A. The Bona Fide Hedging Definition Must be Broadened and Clarified

CME Group supports a bona fide hedging definition that encompasses all reasonable commercial risk reduction strategies so as to allow commercial market participants to have certainty about the legitimacy of their traditional hedging operations and continue with such operations uninterrupted. To this end, the Reproposal's bona fide hedging definition must be broadened and clarified by incorporating the changes detailed below. Such changes would be consistent with the statutory definition of bona fide hedging, the CEA's stated purpose of promoting "sound risk management," and Dodd-Frank's legislative history, which shows that Congress never contemplated depriving hedgers of risk management tools or making such tools prohibitively costly.[3]

[3] *See, e.g.,* Letter from Sen. Christopher Dodd and Sen. Blanche Lincoln to Rep. Barney Frank and Rep. Colin Peterson (June 30, 2010) (stating that the Commission "must not make hedging so costly it becomes prohibitively expensive for end users to manage their risk").

i. Clarification of risks covered by general bona fide hedging definition

In interpreting the bona fide hedging definition in CEA Section 4a(c)—specifically, the "economically appropriate" test—to only cover the reduction of *price* risks (and not any other commercial risks), the Reproposal has disregarded administrative history and legislative history which support a broader conception of bona fide hedging. As the Reproposal acknowledges, the Dodd-Frank statutory bona fide hedging definition retained the "economically appropriate" test from CFTC Rule 1.3(z), but eliminated the "incidental test" referring to the offset of "price risks" incidental to commercial cash or spot operations. According to a 1987 CFTC Interpretation, the "economically appropriate" test is a "more general requirement" than what is captured by the "incidental test" relating to price risks. *See* "Clarification of Certain Aspects of the Hedging Definition," 52 Fed. Reg. 27195, 27196 (July 20, 1987). Furthermore, the CFTC's proposal for Rule 1.3(z) stated that the general bona fide hedging definition was intended to "describe the *broad scope* of risk shifting transactions." 42 Fed. Reg. 14832, 14833 (March 16, 1977). That same proposal never limited relevant risks to *price* risks in laying out the "basic conditions" for bona fide hedging as follows:

> [The bona fide hedging transaction or position] must be economically appropriate to the reduction of risk, such risks must arise from operation of a commercial enterprise, and the price fluctuations of the futures contracts used in the transaction must be substantially related to the fluctuations of the cash market value of the assets, liabilities or services being hedged.
>
> *Id.*

To the extent that the bona fide hedging definition's reference to "fluctuations of the cash market value of the assets, liabilities or services being hedged" relates to price risks, there is no reason (and the CFTC historically never identified a reason) to disallow hedging of other risks that inform and determine price risk. Indeed, the Reproposal would even allow exchanges to "recognize non-enumerated bona fide hedging positions under the process of 150.9 . . ., subject to assessment of particular facts and circumstances, where price risk arises from other types of risk." Reproposal at 96746. Rather than leave any murkiness as to the scope of risks covered by the bona fide hedging definition, the CFTC should clarify that such risks include both price risks and other risks arising from the conduct of a commercial enterprise (e.g., operational risk, liquidity risk, credit risk, locational risk, seasonal risk, etc.). This clarification would also be in line with Dodd-Frank legislative history: notwithstanding various changes that Dodd-Frank made to the CEA's bona fide hedging definition in relation to physical commodity derivatives, Dodd-Frank retained CEA Section 4a(c)'s broad statutory guidance referring to fashioning a bona fide hedging definition to "permit [the] hedg[ing] of [] legitimate anticipated business needs." *See* 7 U.S.C. § 6a(c).

ii. Expansion of list of enumerated hedges

CME Group understands the Commission's view that "it is not possible to list all positions that would meet the general definition of bona fide hedging position." Reproposal at 96751. Nevertheless, CME Group believes that the Commission should include as enumerated hedges at least all of the customary commercial practices detailed in the January 20, 2012, petition submitted to the CFTC by the Working Group of Commercial Energy Firms ("Working

Group").[4] The CFTC does not clearly explain why it declined to include such risk-reducing practices in its list of enumerated hedges, and merely alludes to the examples being "general." Reproposal at 96751. But the Working Group's petition described relevant facts and circumstances and provided explanations for why each example represented a bona fide hedging transaction. The Commission simply observes that if, following the adoption of position limits, other enumerated hedges become appropriate to add, then exchanges may file a petition under Rule 13.2 to achieve that goal. *See* Reproposal at 96815. Noting that future remedies are available is hardly a response to why the Working Group's hedge examples should not be enumerated now. Not only would such future petitions be needlessly time-consuming and resource-intensive for the Commission, exchanges, and market participants, but the value of such a process seems illusory if the Commission were to remain opposed—without any reasoned basis—to adding enumerated hedges along the lines of what the Working Group has proposed. By acting now to include the Working Group's examples as enumerated hedges, the Commission would conserve resources and give proper recognition to customary risk-reducing practices.

An expansion of the reproposed list of enumerated hedges—by removing the five-day rule (discussed below) and including other customary hedging practices—also will result in greater certainty for market participants, exchanges, and even the Commission. Every enumerated hedge carries with it an assurance that a particular trading strategy qualifies as a bona fide hedge and will not be second-guessed by the Commission. Market participants can therefore rely on an enumerated hedge in a way that is not possible with a NEBFH exemption due to the CFTC's ability to overturn an NEBFH exemption under the Reproposal. Indeed, the Reproposal empowers the Commission to conduct a *de novo* review of any NEBFH exemptions recognized by an exchange. *See* Reproposed § 150.9. CME Group believes that enlarging the sphere of enumerated hedges, and consequently limiting the universe of hedging positions that could be considered for NEBFH exemptions, will cultivate a regulatory climate of enhanced certainty and reliability and enable market participants to conduct their hedging operations without fear of interruption.

iii. Removal of five-day rule from enumerated hedging categories

CME Group again urges the Commission to not apply a five-day rule to any enumerated hedging category including provisions relating to pass-through swap offsets and pass-through swaps. In reproposing the five-day rule, the CFTC has not directly responded to CME Group's prior comments that the five-day rule is an unnecessary and inappropriate restriction on hedging using physically-delivered contracts in the spot month (or in the last five days of trading, whichever is shorter). As we pointed out—to the extent that the five-day rule stems from concerns about protecting the price discovery process in physically-delivered contracts especially as those contracts approach expiration—such concerns are addressed through the Core Principle 4 obligations of exchanges. *See* 7 U.S.C. § 7(d)(4) (DCM Core Principle 4); 7 U.S.C. § 7b-3(f)(4) (SEF Core Principle 4).[5] Through fulfilling those obligations to "prevent manipulation, price distortion, and disruptions of the delivery or cash-settlement process,"

[4] *See* "Petition for Commission Order Granting Exemptive Relief for Certain Bona Fide Hedging Transactions Under Section 4a(a)(7) of the Commodity Exchange Act," dated January 20, 2012, *available at* http://www.cftc.gov/stellent/groups/public/@rulesandproducts/documents/ifdocs/wgbfhpetition012012.pdf.

[5] *See* 2016 Comment Letter, *supra* note 2, at 6.

exchanges could not—and would not—recognize a position limit exemption that would lead to such manipulation, price distortion, or disruptions. Accordingly, the CFTC need not impose a five-day rule to limit hedge exemptions. Moreover, the five-day rule would inappropriately and unnecessarily draw liquidity away from physically-delivered benchmark contracts and toward look-a-like cash-settled contracts, thereby compromising the price discovery function of the physically-delivered market in contravention of a key statutory objective set forth in CEA Section 4a(a)(3). *See* 7 U.S.C. § 6a(a)(3)(B)(iv) (directing the CFTC in exercising its position limit authority to "ensure that the price discovery function of the underlying market is not disrupted").

Yet, rather than address head-on the valid objections of CME Group and other commenters, the Reproposal vaguely refers to the five-day rule as a "prudential condition" and alludes to a "long history of applying the five-day rule, in [the CFTC's] legacy agricultural federal position limits . . . ." Reproposal at 96752. Notably, the Commission itself recognizes that the historical application of the five-day rule was limited to legacy agricultural contracts. In other markets, exchanges have been free to grant exemptions in the last five days of trading. The "long history" the Commission cites therefore actually supports eliminating the five-day rule for non-agricultural commodities from the Reproposal. The Commission has provided no precedent or explanation to depart from this history by applying the five-day rule to physically-delivered contracts across the 25 referenced commodity markets.

CME Group maintains that the five-day rule is a wholly unnecessary restriction for any contract, including the legacy agricultural contracts; however, if the CFTC insists on applying the restriction, then it would need to be applied in a fair manner to any referenced contract position so as not to favor cash-settled contract positions. Furthermore, although the Reproposal would allow exchanges to "waive" the five-day rule "on a case-by-case basis" in recognizing NEBFH exemptions, CME Group does not believe that exchanges should have to overcome a restriction that is unnecessary and inappropriate in the first place through a facts-and-circumstances analysis—the results of which market participants may not even be able to rely on due to uncertainty as to what standard the CFTC will use to determine if the Commission agrees with an exchange's decision. For all of these reasons, the Commission should abandon entirely the proposed five-day rule.

B. Clarifications and Enhancements Are Needed for a Workable Exchange-Administered Process for NEBFH and Other Federal Limit Exemptions

CME Group supports the Commission's proposal to authorize exchanges to grant NEBFH and other exemptions from federal limits, but urges the CFTC to make the proposed exchange-administered process more workable through several revisions and clarifications. The following sections identify and discuss those revisions and clarifications.

i. If the five-day rule is not eliminated entirely, the Commission should clarify what it means for an exchange to waive the five-day rule "on a case-by-case basis"

The Reproposal would allow exchanges to "recognize positions, on a case-by-case basis in physical-delivery contracts that would otherwise be subject to the five-day rule, as non-enumerated bona fide hedging positions, *by applying the exchanges experience and expertise in protecting its own physical-delivery market.*" Reproposal at 96752 (emphasis added). CME Group interprets this ability to waive the five-day rule "on a case-by-case basis" to mean that

exchanges have the flexibility to grant NEBFH exemptions consistent with their current and historical practices and exemptions previously granted. If an exchange's waiver authority is interpreted this way, market participants will have greater certainty that they can rely on an exchange's grant of an NEBFH exemption during the last five days of trading (or spot month) so long as the exchange exercised its judgment based on its experience and expertise. Due to CME Group's concern that any greater obligation or expectation on the exchange could render the "waiver" authority virtually meaningless and could subject an exchange to constant overruling by the CFTC, CME Group asks that the Commission confirm CME Group's interpretation.[6]

ii. The CFTC should clarify the applicability of the exchange-administered NEBFH process to OTC positions

CME Group had asked the CFTC to clarify an exchange's obligation regarding recognizing and monitoring NEBFH exemptions for OTC positions under reproposed section 150.9.[7] The Reproposal clarifies that "exchanges do not have an obligation to *monitor* for compliance with OTC-only positions." Reproposal at 96819 (emphasis added). However, the Reproposal does not address CME Group's prior comment that the actual text of reproposed section 150.9, which governs the exchange-administered NEBFH exemption process, nowhere mentions OTC positions; rather, the rule text refers to referenced contracts listed by an exchange.[8] To the extent that the Commission intends for the NEBFH process under proposed section 150.9 to be made available to exemptions requests relating to OTC positions—as the Commission had indicated in its June 13, 2016, supplementary hedging proposal[9]—the Commission should revise the text of section 150.9 to refer explicitly to OTC positions. Such clarity is critical for exchanges to administer the NEBFH exemption process in line with Commission expectations.

iii. The CFTC should eliminate the "actively-traded" pre-requisite for processing exchange-administered exemptions

The Reproposal does not directly address CME Group's comments regarding the lack of need for the "actively traded" requirement (i.e., requirement that exchanges only be allowed to process exemptions for contracts that are "actively traded" on the exchange).[10] Instead, the Reproposal simply intimates that an exchange would not have an *interest* in protecting a market that is not actively traded, and asserts that commenters have not provided an alternative to the "actively traded" requirement that would ensure that "an exchange's interests [are] aligned with that of the Commission." Reproposal at 96819 (emphasis added).

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[6] If the five-day rule is not abandoned in its entirety, the Commission should also provide enhanced clarity by giving examples of situations where it would not agree with an exchange granting a waiver from the five-day rule. Otherwise, exchanges would not fully understand what standard to apply to waiving a rule that CME Group believes is completely unnecessary.

[7] *See* 2016 Comment Letter, *supra* note 2, at 11-12.

[8] *See* 2016 Comment Letter, *supra* note 2, at 11.

[9] *See* 81 Fed. Reg. 38458, 38471 (June 13, 2016).

[10] *See* 2016 Comment Letter, *supra* note 2, at 13-14.

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In clinging to the "actively traded" requirement, the Commission stakes out a very tenuous position. First, the CFTC's position seems incompatible with its indication (discussed above) that exchanges could consider NEBFH applications relating to OTC contracts, which are not listed by an exchange, nevermind "actively traded" on the exchange. Second, CME Group made clear that Core Principle 4 ensures that exchanges' interests are aligned with those of the Commission, thereby rendering the "actively traded" requirement unnecessary.[11] Under Core Principle 4, exchanges must protect their markets (whether or not the market is "actively traded") by "prevent[ing] 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." 7 U.S.C. § 7(d)(4). Thus, pursuant to this core principle, exchanges have a clear interest in protecting their markets, even those that are not actively traded, in line with the Commission's policy objectives in CEA Section 4a(a)(3). Accordingly, the CFTC has no basis for including the "actively traded" requirement and should remove that requirement.

iv. The CFTC should further clarify reporting requirements for exchange-administered exemptions

The Reproposal establishes as a baseline that exchanges administering federal limit exemptions must have reporting rules governing information to be collected from exemption recipients. Specifically, the relevant rule text in reproposed section 150.9 (NEBFH exemptions) and reproposed section 150.10 (spread exemptions) states that an exchange electing to process exchange-administered exemption applications "shall file new rules or rule amendments pursuant to part 40 of this chapter, establishing or amending requirements for an applicant to file reports pertaining to the use of any such exemption that has been granted in the manner, form, and frequency, as determined by [the exchange]." In the preamble to the Reproposal, the CFTC clarifies that exchanges "are authorized to, rather than required to, determine whether to require enhanced reporting" from such exemption recipients. Reproposal at 96823-24. CME Group Exchanges already have rules enabling them to get information from exemption recipients. Thus, we understand the Reproposal to allow the Exchanges the discretion—but not obligation—to request the reporting of additional information from exemption recipients in the form and manner specified by relevant Exchange, not the form and manner that the Commission would dictate. We ask the Commission to confirm CME Group's understanding on this point.

v. Exchanges should be allowed to grant retroactive exemptions for NEBFH positions

The Reproposal would limit retroactive federal hedging exemptions to enumerated hedges. *See* Reproposal at 96823. This feature of the Reproposal would not be as concerning if the list of enumerated hedges is expanded as CME Group has advocated in section A. ii. above. Absent this expansion of enumerated hedges, retroactive exemptions should be allowed in non-enumerated bona fide hedges as well as enumerated hedges. As CME Group pointed out in a prior comment letter, retroactive exemptions are needed when market participants have

[11] *See* 2016 Comment Letter, *supra* note 2, at 13.

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unforeseen hedging needs.[12] Such hedging needs should not be considered less valid because the hedge would be an NEBFH, as opposed to an enumerated hedge. Moreover, exchanges have already established frameworks for granting retroactive exemptions—whether for enumerated hedges or NEBFHs—on their markets. In administering these frameworks, exchanges apply their "experience and experience in protecting [their] own [] market[s]"—which the Commission has cited as the basis for allowing exchanges to waive the five-day rule and administer federal position limit exemptions in general. *See* Reproposal at 96752, 96813-14. The Commission's reliance on the exchange's experience and expertise should mitigate the Commission's stated concerns about needing to timely review an exchange determination to retroactively grant an NEBFH exemption. Accordingly, the Reproposal's restriction on retroactive NEBFH exemptions is not necessary and should be dropped from any final rule.

II. REPROPOSED FEDERAL SPOT-MONTH LIMITS

The Commission may only impose federal spot-month limits if such limits are "necessary" and "appropriate," as required by statute. As explained in the Appendix to this letter, the Commission has not fulfilled its statutory obligation to find federal spot-month limits to be "necessary" on an individualized, commodity-by-commodity basis. Further, even if the limits were accompanied with the requisite "necessary" finding, the Reproposal sets forth a spot-month limit regime that would flout the statutory "appropriateness" framework in CEA Section 4a(a)(3), which requires that limits be designed, to the maximum extent practicable, to meet four objectives: 1) diminish, eliminate, or prevent excessive speculation; 2) deter and prevent market manipulation, squeezes, and corners; 3) ensure sufficient liquidity for bona fide hedgers; and 4) ensure that the price discovery function of the underlying market is not disrupted. *See* 7 U.S.C. § 6a(a)(3). CME Group has set and enforced spot-month limits for physical commodity markets for many years. Based on that experience, we have submitted to the Commission the spot-month levels we believe to be appropriate. In addition, as an overarching principle, CME Group believes that an "appropriate" federal spot-month position limits regime—one consistent with the law and sound policy—would set limits at exchange-recommended levels and apply the same level to physically-delivered benchmark contracts and their cash-settled look-a-like contracts. The following sections expound upon CME Group's comments and recommendations.

A. Set Federal Spot-Month Limits at Exchange-Recommended Levels

As a general guideline, CME Group maintains that, in setting federal spot-month limit levels, the Commission should adopt the levels recommended by the exchange listing the physically-delivered core referenced futures contract because the exchange has the most direct expertise and familiarity with the trading dynamics of its contract markets and other relevant factors including measuring deliverable supply. In CME Group's September 12, 2016, submission to the CFTC, CME Group recommended spot-month limit levels for 17 individual commodity markets.[13] Such levels reflect CME Group's knowledge of the particular characteristics of those contract markets and were carefully calibrated to ensure that CEA

[12] *See* 2016 Comment Letter, *supra* note 2, at 12-13.

[13] *See* Letter from CME Group to CFTC re Recommended Federal Spot-Month Limit Levels, dated September 12, 2016 ("Recommended Levels Submission"), *available at* https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=61007&SearchText=cme.

Section 4a(a)(3)'s position limit objectives are served—i.e., allowing for reasonable (as opposed to excessive) levels of speculation, guarding against manipulation, providing for sufficient liquidity for bona fide hedgers, and protecting the price discovery function of the underlying physical delivery market. Although the Commission has reproposed spot-month limit levels at CME Group's recommended levels for agricultural and metals markets, the Reproposal would set higher limits in the crude oil, ULSD, and RBOB markets than we recommended and would allow for an expanded conditional spot-month limit in the natural gas market (discussed in section B. below). CME Group opposes the CFTC's decision to deviate from the CME Group-recommended levels in these markets.

CME Group's recommended spot-month limit levels for the energy markets reflect a substantial yet prudent increase relative to the exchange-set spot-month limits in effect today. The increase in levels is due in large part to CME's application of updated deliverable supply estimates reflecting current market conditions. Consistent with the Acceptable Practices for DCM Core Principle 5, CME Group proposed levels that do not exceed 25 percent of the relevant updated deliverable supply estimate. In particular, for RBOB, crude oil, and ULSD, the recommended limit levels were set below 25 percent of updated deliverable supply, and for natural gas, the recommended limit level was set at 25 percent of updated deliverable supply. Each of the recommended limit levels in these energy markets represent two times the respective present-day limit level. By stark contrast, the Reproposal would set exponentially higher spot-month limit levels: an RBOB limit level at *seven* times the present-day level, a crude oil limit level at more than *three* times the present-day level, and a ULSD limit level at nearly *three* times the present-day level. Particularly at the initial phase of any new federal position limits regime, CME Group believes that the prudent course of action would be to adopt CME Group's recommended limit levels, rather than the Reproposal's significantly higher limit levels that would increase the risk of burdensome excessive speculation.

The Reproposal offers no reasoned basis for overriding CME Group's recommended limit levels for the relevant energy markets. Instead, the Reproposal merely states that "the Commission *believes* that higher levels will lessen the impact on a number of traders in both cash settled and physical delivery markets." Reproposal at 96764. The Commission's "belief" is not backed with any evidence of traders (or markets in general) facing an adverse impact from the CME Group-recommended limit levels. Ironically, the Reproposal's higher limit levels could adversely affect traders and market integrity by increasing the potential for the following harmful scenario the Commission itself describes:

> Willingness to participate in the futures and swaps markets may be reduced by perceptions that a participant with an unusually large speculative position could exert unreasonable market power. A lack of participation in these markets may harm liquidity, and consequently, may negatively impact price discovery and market efficiency as well.
>
> Reproposal at 96842.

Thus, the Commission has engaged in double-speak, recognizing that allowing for excessive speculation would harm liquidity and yet advocating for higher limits to purportedly ensure liquidity and "lessen the impact" on traders. Rather than proceed down the potentially dangerous path of inviting market harms through limit levels that would increase the risk of

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excessive speculation, the Commission should adopt the CME Group-recommended levels for all energy markets.

B. Adopt Spot-Month Limit Parity for Linked Cash-Settled and Physically-Delivered Markets

CME Group believes that spot-month limit parity for linked cash-settled and physically-delivered markets should be adopted in any final position limit rules. To that end, we would support the Commission not applying a higher, conditional cash-settled limit in any commodity market. Setting spot-month limits at parity has proven an effective, longstanding approach and is founded on the congressionally-recognized principle that there is no reason to treat linked contract markets differently. As CME Group explained at length in prior comments,[14] Congress understood in its enactment of CEA Section 4b (and the CFTC reaffirmed in its implementing regulations) that by using "comparable" limits for cash-settled and physically-delivered contracts, the price discovery process of the linked markets would be protected. *See* 7 U.S.C. § 6(b)(1)(B) (requiring FBOT cash-settled contracts to have "comparable" limits to their linked DCM benchmark futures); 17 C.F.R. § 48.8(c)(1)(ii)(A) (same); *see also* 76 Fed. Reg. 80674, 80698 (Dec. 23, 2011) (explaining the basis for the comparability requirement).[15]

Seemingly accepting the strong legal and policy basis for spot-month parity, the Commission has reproposed to adopt spot-month limit parity for every referenced commodity market, with one outlier. For the natural gas market, the Commission appears to have disregarded the import of CME Group's statutory "comparability" argument[16] and the compelling policy need for spot-month limit parity, instead reproposing a federal conditional spot-month limit for cash-settled natural gas contracts that would be *five* times the reproposed spot-month limit of 2,000 for a physically-delivered contract. To claim this expanded conditional cash-settled limit of 10,000, a trader would have to forgo *any* positions in the related physically-delivery contract. Thus, far from providing a "comparable" limit structure for linked markets, the CFTC has reproposed a structure of an extraordinarily large limit for one market (i.e., 10,000) and what is effectively a position prohibition in the other (i.e., zero). The Reproposal would also codify an "acceptable practice" for exchanges to apply a conditional cash-settled spot-month limit to

[14] *See, e.g.*, Recommended Levels Submission, *supra* note 13, at 2-4.

[15] In a footnote of the Reproposal, the Commission notes that "[CME Group's comparability argument as expressed in the Recommended Levels Submission dated September 12, 2016] incorrectly attributed preamble language as pertaining to § 48.8(c)(1)(ii)(A), which addresses statutory requirements, when [CME Group] stated that the Commission acknowledged that a linked contract and its physically-delivered benchmark contract 'create a single market' capable of being affected through trading in either of the linked or physically-delivered markets' as this discussion actually addressed the Commission's adoption of its second set of conditions for linked contracts, found in § 48.8(c)(2) (Other Conditions on Linked Contracts)." Reproposal at 96794 n. 845. However, the Commission ignores the key fact that, in the rulemaking adopting Regulation 48.8(c)(1)(ii)(A), the CFTC did acknowledge that linked contracts and physical delivery contracts form a single market. That the CFTC's particular "single market" statement appeared closer to the discussion of a slightly different subsection number (§ 48.8(c)(2)), which was also concerned with "Linked Contracts," does not undermine CME Group's point that even the regulator itself has found interconnectedness between cash-settled and physically-delivered contracts.

[16] The Commission cites CME Group's "comparability" argument in a different part of the Reproposal where it reproposes guidance for exchanges with respect to physical commodity derivatives that are not subject to federal limits. Specifically, the Commission said that it was changing its guidance so that such physical commodity derivatives that reference the price of a contract listed by an exchange would have limits that are "comparable" to the limits for the benchmark contract. *See* Reproposal at 96795.

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commodity markets outside the 25 referenced commodity markets subject to federal limits. Much like the federal conditional limit for natural gas, the reproposed exchange conditional limits would result in a vastly disproportionate limit structure: a trader could hold a cash-settled contract position that is *double* the size of the spot-month limit for the physically-delivered contract, provided the trader holds *no* positions in the spot-month physical delivery contract.

CME Group strongly opposes the Reproposal's federal conditional spot-month limit for the natural gas market as well as its "acceptable practice" for exchange-imposed conditional spot-month limits. The CFTC's purported basis for including such conditional spot-month limit provisions is glaringly inchoate. On one hand, the Commission recognizes that the conditional spot-month limits enable "transactions of large speculative traders [which] may tend to cause unwarranted price changes." Reproposal at 96797. But, on the other hand, the Reproposal indicates that the burdensome excessive speculation resulting from the conditional spot-month limits "is *warranted* [where] . . . a speculative trader is demonstrably providing liquidity for bona fide hedgers." Reproposal at 96797. As explained above, the Commission is espousing two contradictory positions: it is acknowledging that excessively large speculative positions can *harm* market integrity and liquidity while insisting on increasing limits which would heighten the potential for excessive speculation in order to *provide* liquidity purportedly to benefit hedgers.

Not only is the CFTC's liquidity rationale internally inconsistent, but it also lacks a transparent market analysis or other credible, empirical data. For the natural gas market, the Reproposal provides an "impact analysis" showing that "for natural gas referenced contracts, 131 unique persons had cash-settled positions in excess of [the limit level of 2,000 that would be applied to cash-settled natural gas contracts absent a conditional spot-month limit]." Reproposal at 96779. The Reproposal goes on to say that, in exceeding 2,000 positions, such market participants "did not have a position that was extraordinarily large in relation to other traders' positions in cash-settled contracts," and that "a conditional spot-month limit exemption . . . would provide relief" to such market participants (Reproposal at 96780) and "would potentially benefit many traders." Reproposal at 96859.

Notably, this impact analysis suffers from oversimplification and opaqueness. It never identifies a metric for what is "extraordinarily large." It also fails to explain why its assessment of what is an "extraordinarily large" cash-settled position in the natural gas market should depend on position size in other markets (i.e., "in relation to other traders' positions in cash-settled contracts"). Indeed, this approach is counter to the Commission's own statement that, for conditional spot-month limits, "considerations may vary, and should be considered *in relation to the particular commodity at issue*." Reproposal at 96778. Furthermore, the impact analysis never discloses whether the market participants in excess of the limit of 2,000 were hedgers or speculators, or both. If the market participants were hedgers, then there would be no need to provide "relief" to such hedgers through a higher conditional limit because bona fide hedgers, by statute, are not subject to limits and thus can exceed speculative limits. And if some or all of the 131 market participants exceeding the limit were speculators, then the Commission has not shown by how much these speculators are exceeding the limit and, more importantly, has provided no evidence that the excess cash-settled positions of these speculators are needed to "ensure sufficient liquidity for bona fide hedgers."

Moreover, in fixating on a purported need for liquidity for bona fide hedgers in the cash-settled market, the Commission completely ignores the impact of a conditional spot-month limit on liquidity in the physical delivery market. Hedgers rely on physically-delivered contracts and

need liquidity to enter into those contracts and hold positions into the spot month (when they will either make or take delivery or roll their positions prior to expiration). Such liquidity would be depleted for these hedgers under the reproposed conditional limit provisions as traders would exit the physical delivery market to avail themselves of the higher conditional cash-settled spot-month limit. The Commission offers no impact analysis for the loss of liquidity in the physical delivery market, thereby providing an even more fragmented and deficient foundation for its conditional limit reproposal. Overall, the Commission has failed to explain why additional "relief" is needed for speculators in the cash-settled market when the "relief" afforded by the conditional spot-month limit would increase the risk of excessive speculation and associated market harms.

Ultimately, the CFTC has not provided a reasoned basis for imposing a conditional spot-month limit in the natural gas market or any other market. As indicated above and as CME Group has explained in numerous prior submissions,[17] the proposed federal conditional spot-month limit would pose many adverse regulatory consequences. Given that a condition of the expanded limit for cash-settled contracts is *not* holding a spot-month position in the related physically-delivered benchmark contract, the conditional limit operates to drain liquidity from that physically-delivered contract. 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 in physical delivery markets would also harm hedgers (and ultimately consumers) in contravention of CEA Section 4a(a)(3)(B)(ii). Furthermore, a trader availing himself of the expanded conditional limit and holding an uncapped cash market position—which the proposed conditional limits framework would not preclude—would be incentivized and able to manipulate the cash commodity market (and related physically-delivered contract) in order to benefit the trader's leveraged cash-settled contract position. This result clearly runs afoul of the position limit objective of "deter[ring] and prevent[ing] market manipulation, squeezes, and corners," as set forth in CEA Section 4a(a)(3)(B)(ii). In sum, the proposed federal conditional spot-month limit would violate all of the statutory touchstones for an "appropriate" position limits framework.

III. REPROPOSED FEDERAL NON-SPOT-MONTH LIMITS

As discussed in the Appendix to this letter, the CEA empowers the CFTC to impose position limits only as "necessary." CME Group does not believe that federal non-spot-month position limits can be found necessary at an initial phase of implementing any new federal position limit regime. First, the Commission has yet to gauge the effectiveness of any federal spot-month limits that would be imposed and determine whether hard caps would be necessary outside the spot month or whether such hard caps would instead needlessly constrain liquidity essential for hedgers to obtain cost-effective hedges. Second, the Commission has not provided any evaluation of the effectiveness of the current exchange system of non-spot-month position accountability to address any burdensome excessive speculation outside of the spot month. Position accountability has long served and continues to serve as an important tool that limits the amount of exposure a trader may have before triggering regulatory surveillance and potentially having to freeze or drawn down the trader's position (or take no action). For its part,

[17] *See, e.g.*, 2014 Comment Letter, *supra* note 2, at 26-39; Letter from CME Group to CFTC re Position Limits for Derivatives (RIN 3038-AD99), dated August 4, 2014, *available at* https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=59971&SearchText=cme; 2016 Comment Letter, *supra* note 2, at 3-5.

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Congress has expressly endorsed position accountability as an alternative to hard cap position limits in the statutory core principles for exchanges (see CEA Section 5(d)(5)), and Dodd-Frank did not eliminate or reduce the availability of position accountability. Ultimately, if the exchange system of position accountability is adequate to address the Congressional concerns with excessive speculation, then there would be no necessity to implement a federal non-spot-month position limit regime.

In the event that the Commission insists on imposing a *federal* position limit measure outside of the spot month, CME Group would strongly urge the Commission to employ a federal position *accountability* limit system as opposed to hard cap limits. Such accountability system could be designed along the lines of CME Group's proposal in its January 22, 2015, comment letter.[18] The Reproposal pays only lip service to this prospect, saying that CEA Section 4a does not specifically refer to federal position accountability and thus the CFTC lacks the statutory authority to impose a federal position accountability regime. Reproposal at 96715. However, the CEA authorizes the CFTC to impose hard cap position limits only as "necessary" (*see* Section 4a(a)(1)), acknowledges that burdensome excessive speculation is an important congressional objective (*see* Section 4a(a)(1)) and expressly allows the CFTC to promulgate rules that in its judgment are reasonably necessary to effectuate the CEA's purposes (*see* Section 8a(5))—this combination of statutory cues would support the imposition of federal accountability limits. Although the Reproposal contends that—compared to position accountability limits—hard cap "position limits with an exemption process is the better approach because it benefits the supervisory functions of the exchanges and the Commission by providing better insight into the markets," the Reproposal fails to explain why a federal position accountability regime would provide less "insight into the markets" than federal hard cap position limits or otherwise be less effective. *See* Reproposal at 96846.

IV. REPROPOSED GUIDANCE FOR EXCHANGES ON APPLICATION OF FEDERAL AGGREGATION RULES

Under the Reproposal, exchanges would be *required* to conform their aggregation provisions for physical commodity derivative contracts to the Commission's federal position aggregation rules in Regulation 150.4. Reproposal at 96799. With respect to excluded commodity derivatives, the Reproposal sets forth an "acceptable practice" whereby exchanges "should" conform their aggregation provisions to Regulation 150.4. Reproposal at 96799. Because Regulation 150.4 will, in effect, serve as the template for an exchange's aggregation provisions, CME Group believes that there should be absolute clarity regarding application of Regulation 150.4. In particular, CME Group seeks to confirm its understanding of Regulation 150.4(c)(6), which allows for late notice filings for aggregation exemptions as follows:

> If a person is eligible for an aggregation exemption under paragraph (b)(1)(ii), (b)(2) [owned entity aggregation exemption], (b)(3), (b)(4), or (b)(7) of this section, a failure to timely file a notice under this paragraph (c) shall not constitute a violation of paragraph (a)(1) of this section or any position limit set forth in § 150.2 if such notice is filed *no later than five business days after the person is aware, or should be aware, that such notice has not been timely filed*."

[18] *See* Letter from CME Group to CFTC re Re-Opening of Comment Period for Position Limits for Derivatives (RIN 3038-AD99) and Aggregation of Positions (RIN 3038-AD82), dated January 22, 2015, at 5-7, *available at* https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=60307&SearchText=cme.

17 C.F.R. § 150.4(c)(6) (emphasis added).

CME Group understands Regulation 150.4(c)(6) to be compatible with existing exchange aggregation provisions that allow a market participant five business days after exceeding a position limit to make a notice filing for an aggregation exemption, provided that the person is otherwise eligible to claim the aggregation exemption. In other words, for purposes of Regulation 150.4(c)(6), the five-day clock starts running from the point in time in which the person becomes aware that it has exceeded a position limit because of aggregation from which it could have been exempt. CME Group believes that this interpretation would not only be consistent with current exchange practices, but would also be in accordance with the purpose behind Regulation 150.4(c)(6). As the Commission explained in its rulemaking adopting Regulation 150.4(c)(6), the provision is meant to "address a situation where a person is eligible to claim an exemption from aggregation, but does not make a filing at the proper time." *See* 81 Fed. Reg. 91454, 91471 (Dec. 16, 2016). This situation could certainly arise where a person who is eligible to claim an aggregation exemption (e.g., owned entity aggregation exemption) exceeds a position limit and becomes aware at that point that it had not timely made an aggregation exemption filing. CME Group requests that the CFTC confirm that, consistent with Regulation 150.4(c)(6), such person would have five business days from the time it exceeded the position limit to make the required notice filing and, in doing so, such person would not be found to have violated the position limit.

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CME Group appreciates this opportunity to comment on the Reproposal. 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.

Sincerely,

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Cc: Honorable J. Christopher Giancarlo, Acting Chairman
Honorable Sharon Bowen, Commissioner
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APPENDIX:
FLAWS IN REPROPOSAL'S PREDICATE LEGAL DETERMINATIONS

The Reproposal is predicated on two legal determinations: 1) the Commission's latest interpretation of what it claims to be a statutory mandate to impose position limits on physical commodity derivatives even if the Commission has not found limits to be necessary and 2) the Commission's general finding in any event that "the speculative position limits in the reproposed Rule are necessary to achieve their statutory purposes." Reproposal at 96716. Both determinations are flawed and cannot serve as the basis for the imposition of limits.

Contrary to the Commission's assertions, neither the text of the CEA considered as an integrated whole nor the "lens of the Commission's experience and expertise" support interpreting the statute to contain a position limits mandate. *See* Reproposal at 96713. Rather, under the CEA, as amended by Dodd-Frank, the Commission has the authority to impose position limits only if it first makes a finding that limits are necessary. Although the Reproposal offers a blanket "necessary" finding as a secondary legal determination, that finding proves woefully inadequate in light of the text of CEA Section 4a(a)(1), the Commission's historical practice, and relevant statutory context. Taken together, these sources require a commodity-by-commodity finding of position limits being necessary to prevent excessive speculation causing unwarranted or unreasonable price fluctuations in a particular commodity.

In the sections below, CME Group dissects in greater detail the Reproposal's flawed predicate determinations.

A. <u>The CFTC's Position Limits "Mandate" Interpretation Is Not Reasonable in Light of the Commission's Experience and the Statutory Text Itself</u>

In the Reproposal, the Commission states that it did not need to make a necessity finding because Congress mandated the imposition of position limits on physical commodity derivatives even where the CFTC did not find them to be necessary. *See* Reproposal at 96708-16. In trying to glean such a congressional mandate from the CEA's provisions, the Commission relies on two aspects of its "experience": 1) a 1981 rulemaking in which the CFTC required exchanges to establish exchange-set position limits ("1981 Rulemaking"), and 2) the Commission's history of making necessity findings. *See* Reproposal at 96708-10. Upon a closer look, neither of these sources actually demonstrates that Congress intended position limits to be imposed without a necessity finding. Moreover, the CFTC's attempts to respond to CME Group's statutory analysis either misunderstand CME Group's arguments or simply fall short of addressing them. In the following sections, we discuss the lack of experiential and textual support for the CFTC's "mandate" interpretation.

i. Misplaced reliance on 1981 Rulemaking

The Reproposal argues that the 1981 Rulemaking confirms that CEA Section 4a(a)(2) sets forth a position limits mandate, notwithstanding the incorporation of Section 4a(a)(1)'s "standards" into Section 4a(a)(2). *See* 7 U.S.C. § 6a(a)(2) (referring to the CFTC acting "in accordance with the standards set forth in [Section 4a(a)(1)]"). This reliance on the 1981 Rulemaking is misplaced in two primary respects. First, the Commission is resting its argument on an untenable premise: a rulemaking promulgated in 1981 serves as an interpretive authority

for a "standards" reference that Dodd-Frank would add nearly 30 years later when enacting CEA Section 4a(a)(2). The Reproposal refers to an "*inference* that Congress was influenced by the 1981 rulemaking in the Dodd-Frank Act amendments," but offers no direct evidence from Dodd-Frank legislative history that Congress indeed used the 1981 Rulemaking as a guide for CEA Section 4a(a)(2)'s cross-reference to "standards" in Section 4a(a)(1). *See* Reproposal at 96711. The second problem with the Commission's reliance on the 1981 Rulemaking is equally, if not more, fundamental. By asserting that the 1981 Rulemaking "is the last time the Commission definitively addressed and identified the 'standards' in CEA Section 4a(a)(1)" and such standards do not include a necessity finding (*see* Reproposal at 96711), the Commission has disregarded the D.C. District Court's opinion vacating the Commission's Part 151 position limits regime. As the district court pointed out, the 1981 Rulemaking did not constitute an interpretation of the applicability of CEA Section 4a(a)(1)'s necessity finding requirement; rather, it was primarily an exercise of rulemaking authority under CEA Section 8a(5). In the district court's words:

> The fact that the CFTC did not make a necessity finding in its 1981 rulemaking does not constitute an interpretation from which this court can infer Congressional ratification. To accept the agency's argument now, this Court would have to find that Congress ratified by silence *an interpretation of Section [4]a(a)(1) that the CFTC made by silence*. The Court simply cannot draw such a conclusion on this record.
>
> *International Swaps and Derivatives Ass'n v. CFTC*, 877 F.Supp.2d 259, 273-74 (emphasis added).

Accordingly, the 1981 Rulemaking cannot be relied upon as a "definitive" guide on whether CEA Section 4a(a) includes the necessity finding requirement in referring to "standards."[1]

In contrast to the 1981 Rulemaking, the CEA's statutory context does shed light on the meaning of "standards" in CEA Section 4a(a). In a different CEA provision—Section 5e—Congress referred to the suspension or revocation of designation of a registered entity "in accordance with the procedures and subject to the judicial review provided in [CEA] section [6](b)." *See* 7 U.S.C. § 7b. Thus, although both Section 4a(a)(2) and Section 5e use an "in accordance with" formulation, Section 4a(a)(2) cross-references "standards" in a specific statutory subsection (Section 4a(a)(1)), and Section 5e cross-references "procedures" in a specific statutory subsection (Section 6(b)). By cross-referencing the "procedures" in Section 6(b), Congress made clear that it was concerned with *how* suspension and revocation were to

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[1] Notably, the Reproposal also seems to have mischaracterized what the term "standards" meant for purposes of the 1981 Rulemaking. In particular, the CFTC asserts that Rule 1.61—the rule adopted through the 1981 Rulemaking— incorporated the 'standards' from then-CEA-section 4a(1)—an 'Aggregation Standard' . . . and a flexibility standard." Reproposal at 96709. However, the only reference to "standard" in the entire text of Rule 1.61 does *not* relate to aggregation or "flexibility." *See* 46 Fed. Reg. 50938, 50945 (Oct. 16, 1981) (stating, in Rule 1.61(a)(2), that "[i]n addition to the above or upon a determination that the above standard [regarding position sizes customarily held by speculative traders] is inappropriate, a contract market may base its determination on other factors [which may include market breadth and liquidity and opportunity for arbitrage] . . ."); *see also id.* at 50942 (under preamble sub-heading "Standards for Establishing Limits," referring to a contract market complying with the "standards and purpose for setting speculative limits set forth in paragraph 1.61(a)"). Indeed, aggregation is addressed in an entirely different provision of Rule 1.61—i.e., paragraph (g).

be imposed, not *whether* there was cause for imposing them. Indeed, Congress could have—but did not—include a cross-reference to the language in Section 6(b) that relates to the basis for the CFTC's suspension and revocation authority. If, as the CFTC suggests, in Section 4a(a)(2) Congress were only concerned with *how* position limits were to be imposed, not whether they were to be imposed, then Congress could have used the term "procedures" just as it did in Section 5e. Congress instead opted for the term "standards" in Section 4a(a)(2), signaling an intent to cover not just *how* position limits are to be imposed, but *whether* they are to be imposed at all. *See Sosa v. Alvarez-Machain*, 542 U.S. 692, 711, n.9 (2004) ("[W]hen the legislature uses certain language in one part of the statute and different language in another, the court assumes different meanings were intended.") (internal quotation marks omitted). Accordingly, Congress's use of the term "standards" in Section 4a(a)(2) encompasses Section 4a(a)(1)'s necessity standard relating to whether limits can be imposed.

ii. Overblown claims of inconsistency between historical necessity findings and Dodd-Frank timing provisions

The Reproposal argues that Congress could not have intended the CFTC to make individualized commodity-by-commodity necessity findings within the "stringent time limits in CEA Section 4a(a)(2)(B)" (i.e., 180-270 days from the enactment of Dodd-Frank), and that the CFTC is instead required to impose limits without such necessity findings. *See* Reproposal at 96708. In essentially treating the statutory deadlines as trumping the CFTC's historical practice of particularized necessity findings, however, the Reproposal glosses over the fact that the CFTC has been violating those deadlines for more than half a decade and counting. Moreover, the Reproposal dismisses the potential that existed for necessity findings to be made within the statutory timeframes. In particular, the prospect of using exchanges and others to expedite the process of making "necessary" findings gets discredited as an approach that is "unlikely" what Congress had in mind and not explicitly set forth in the statute. *See* Reproposal at 96710.

The Reproposal's rejection of what it otherwise recognizes as "a plausible approach to generating necessity findings" (*see* Reproposal at 96710) seems cavalier in the face of the CFTC's willingness and prudence to enlist exchange assistance in other areas that do not expressly call for exchange involvement. One such area is administration of federal position limit exemptions. Although the CEA does not specifically identify exchanges as playing a role in administering federal limit exemptions, the CFTC has wisely delegated the task to exchanges due to the efficacy of such an approach (in light of exchange experience and expertise). That the CFTC refused to similarly explore such a delegation approach for making necessity findings within the statutory timeframes does not mean that such necessity findings were not required. If anything, the availability of this approach indicates that the statutory timeframes do not prove that Congress intended to enact a position limits mandate.

iii. Misunderstanding of and inadequate response to textual arguments against mandate

The Reproposal fails to fairly and fully address various textual arguments raised by CME Group that demonstrate that the "mandate" interpretation is not the better reading of the CEA, as amended by Dodd-Frank. Below we identify CME Group's arguments and the shortcomings in the Reproposal's response.

1. *Implied Repeal of CEA Section 4a(a)(1)'s "Necessary" Finding Requirement*

CME Group has argued that the Commission's "mandate" interpretation is, in effect, a veiled attempt at repealing Section 4a(a)(1)'s "necessary" finding requirement as it relates to physical commodity derivatives.[2] As CME Group has pointed out, repeal by implication will only be permitted where congressional intent to repeal is "clear and manifest" or "such a construction is absolutely necessary." *See Hunter v. FERC*, 711 F.3d 155, 159-160 (D.C. Cir. 2013). In the Reproposal, the Commission does not meet the "high bar of showing an implied repeal," *id.* at 160, but instead seems to be playing a game of semantics. The CFTC says that, rather than work an implied repeal, its statutory interpretation is one of an "express limited exception" for physical commodity derivatives from the "necessary" finding requirement. *See* Reproposal at 96714. CME Group does not see any substantive difference between an "implied repeal" and the Commission's so-called "express limited exception." But what is certain is that the applicable statutory language cannot be said to be "express" given the D.C. District Court's holding that it is ambiguous. Accordingly, the Reproposal has failed to adequately address CME Group's implied repeal argument.

2. *CEA Section 4a(e)'s References to "If" and "Any Contract"*

CME Group has observed that CEA Section 4a(e) undermines the Commission's claim that position limits *must* be imposed regardless of whether the CFTC finds them to be necessary.[3] Section 4a(e) includes the phrase "*if* the Commission shall have fixed limits under [Section 4a] for *any contract*." In the Reproposal, the CFTC essentially claims that Section 4a(e) only applies to a subset of contracts—i.e., contracts that are not physical commodity derivatives subject to Section 4a(a)(2). *See* Reproposal at 96715. The CFTC's reading, however, ignores the plain language of the statute, which refers explicitly to "any contract." *See United States v. Gonzales*, 520 U.S. 1, 5-6 (1997) (finding that the statutory phrase "any other term of imprisonment" means what it says (as opposed to being limited to some subset of prison sentences) because "[r]ead naturally, the word 'any' has an expansive meaning" and "Congress did not add any language limiting the breadth of that word"); *Ali v. Fed. Bureau of Prisons*, 552 U.S. 214, 227-28 (finding that the statutory phrase "any other law enforcement officer" is "an unmodified, all-encompassing phrase" that covers all law enforcement officers, not just those officers acting in a customs or excise capacity). Thus, CEA Section 4a(e) continues to be incompatible with the Commission's view that Congress imposed a position limit mandate for physical commodity derivatives.

3. *CEA Section 5(d)(5)'s "Necessary and Appropriate" Standard for Imposing Exchange Limits*

CME Group has explained that the CFTC's "mandate" interpretation would result in the *very same* type of commodity derivatives—i.e., physical commodity derivatives—being subjected to two *different* standards for the imposition of limits: a mandate for the CFTC to

[2] *See* Letter from CME Group to CFTC re Position Limits for Derivatives (RIN 3038-AD99), dated February 10, 2014, at 12 ("2014 Comment Letter"), *available at* https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=59718&SearchText=cme.

[3] *See* 2014 Comment Letter, *supra* note 2, at 10.

impose limits even if unnecessary, and authority for exchanges to impose limits only as "necessary and appropriate" under CEA Section 5(d)(5). Further, CME Group has noted that this statutory inconsistency would not arise if CEA Section 4a(a) were interpreted to authorize the CFTC to impose position limits only as it finds to be necessary and then only at appropriate levels.[4] In the Reproposal, the Commission merely (and misguidedly) reassures CME Group that exchanges will retain discretion to impose position limits. *See* Reproposal at 96715. Ultimately, the CFTC has failed to address CME Group's fundamental point grounded in the terms of the CEA itself that the statute would not operate harmoniously if the "mandate" interpretation is adopted.

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Tasked with bringing its "experience and expertise" to bear in interpreting the CEA as amended by Dodd-Frank, the CFTC undergirds its interpretation with two flimsy experiential "pillars," as discussed above. With the erosion of support for its "mandate" interpretation along with a flawed textual reading, such interpretation cannot be found to be reasonable, leaving the CFTC with the authority—but not the requirement—to impose limits, provided that it first finds limits to be "necessary."[5]

B. <u>Contrary to the CFTC's Claims, the "Necessity Finding" Requirement Can Only Be Satisfied on a Commodity-By-Commodity Basis and Where Position Limits Are the Only Means of Addressing Burdensome Excessive Speculation</u>

Although the Commission determined in its Reproposal that it is required to impose position limits without making a necessity finding, it nonetheless made a *general* finding that limits are necessary for both the spot-month and outside the spot month to prevent market participants from amassing extraordinarily large speculative positions. *See generally* Reproposal at 96716-22. The Commission's refusal to provide a more particularized, commodity-by-commodity necessity finding does not square with the statute or the CFTC's historical practice. In attempting to respond to CME Group's specific argument in an earlier comment letter that CEA Section 4a refers to preventing "such burden" on "such commodity" and thus contemplates a particularized commodity analysis,[6] the Commission argues that a blanket necessity finding is sufficient because all commodity markets have the same "vulnerabilities." Reproposal at 96718. The CFTC's argument seem detached from the actual workings and nuances of commodity markets (and the wording of the statute that would logically call for a commodity-by-commodity determination). In the context of deciding to not apply federal conditional limits to certain commodity markets, the Commission itself recognized that "considerations may vary, and should be considered *in relation to the particular commodity* at issue," (Reproposal at 96778, emphasis added) and yet the Commission does not explain why this more nuanced approach is not true for deciding whether to set limits at all. The Commission's proposed generic necessity finding also inexplicably departs from the

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[4] *See* 2014 Comment Letter, *supra* note 2, at 11.

[5] Importantly, the House of Representatives has passed a bill that would put an end to the CFTC's unreasonable "mandate" interpretation by stripping out the Dodd-Frank amendments that the CFTC has misconstrued. *See* H.R. 238, 115th Cong. § 321 (2017).

[6] *See* 2014 Comment Letter, *supra* note 2, at 12-13.

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Commission's admitted decades-long precedent of issuing particularized, commodity-by-commodity necessity findings. *See* Reproposal at 96708. The CFTC cites no evidence that Congress intended to have the CFTC depart from its longstanding practice when imposing federal position limits.

As a result of the Commission's broad-brush approach, the Reproposal is founded on sweeping statements that simply prove too much. If, as the CFTC suggests, the mantra "the capacity of any contract market . . . is not unlimited" essentially serves as a sufficient finding for the need to establish limits (*see*, *e.g.*, Reproposal at 96722), then wouldn't the CFTC have a basis to impose limits on every commodity derivative? Why pick just 25 physical commodity markets if the "vulnerabilities" across all markets are the same? By failing to offer a reasoned determination of need in the 25 referenced commodity markets (let alone any commodity market), the CFTC falls woefully short of the necessity finding requirement in CEA Section 4a(a)(1)—as that provision reads and has been historically interpreted—and risks promulgating an arbitrary and capricious agency action.

Moreover, the Commission essentially dismisses comments regarding how position limits cannot be found "necessary" where there are other means of addressing excessive speculation. *See* Reproposal at 96722 ("[T]he Commission rejects such an overly restrictive reading, which lacks a basis in both common usage and statutory construction"). The Commission argues that, even if other tools are available, position limits can be "necessary as a prophylactic tool to strengthen the regulatory framework to prevent excessive speculation *ex ante* to diminish the risk of economic harm it may cause further than it would reliably be from the other tools alone." Reproposal at 96722. In making this argument, however, the Commission contorts the plain text of the statute, which says "necessary to diminish, eliminate, or prevent," *not* "necessary as a prophylactic tool to strengthen the regulatory framework to prevent." An agency may not rewrite its statute to accommodate a regulatory "spirit." *Landstar Express Am., Inc. v Fed. Maritime Commission*, 569 F.3d 493, 500 (D.C. Cir. 2009).

The CFTC's view is also contrary to statutory context and common usage—both of which support a reading of "necessary" as the only means. In terms of statutory context, if Congress had intended to provide a more flexible necessity standard in CEA Section 4a(a)(1) along the lines of what the CFTC suggests, Congress could have used language found elsewhere in the statute. For example, in addressing the CFTC's rulemaking authority in CEA Section 8a(5), Congress framed the necessity standard as "*reasonably* necessary to effectuate any of the provisions or to accomplish any of the purposes of [the CEA]." *See* 7 U.S.C. § 12a(5) (emphasis added) The qualifier "reasonably" on its face signals that absolutely necessity is not required. *See Chrisner v. Complete Auto Transit, Inc.*, 645 F.2d 1251, 1261-62 (6th Cir. 1981) (statutory term "reasonably necessary" is not absolute and does not require complete absence of alternatives). Similarly, in other areas of the CEA, Congress employed the malleable phrase "necessary or appropriate in the public interest" as the relevant necessity standard. *See, e.g.*, 7 U.S.C. § 6n(a)(1) (permitting the CFTC to "prescribe [information for CPO/CTA registration forms] as necessary or appropriate in the public interest"). By using the disjunctive "necessary *or* appropriate," Congress created a standard that would embrace what is suitable rather than just what is indispensable. In CEA Section 4a(a)(1), however, Congress did not use the flexible phrases "reasonably necessary" or "necessary or appropriate"; instead, it used the word "necessary." It is a longstanding canon of statutory construction that "where Congress includes particular language in one section of a statute but omits it in another . . . , it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or

exclusion." *Keene Corp. v. U.S.*, 508 U.S. 200, 208 (1993) (quoting *Russello v. U.S.*, 464 U.S. 16, 23 (1983)). Thus, read in light of the relevant statutory context, the necessity standard in CEA Section 4a(a)(1) signifies a requirement for absolute need, i.e., position limits would be necessary if they are the only means of addressing burdensome excessive speculation. *Cf. Chrysler Corp. v. Brown*, 441 U.S. 281, 317 (1979) (refusing to find an implied private right of action to be "necessary" where an alternative remedy was available).

Reading the necessity standard in CEA Section 4a(a)(1) as requiring absolute necessity is also consistent with common usage of the term "necessary." Consider the following examples that appeal to basic logic: It would not be "necessary" to break down your door in order to get into your locked home when you can use a spare set of keys. It would not be "necessary" to put up a stop sign to handle traffic at a busy intersection when using a traffic light would be a more sensible approach. And it would not be "necessary" to amputate a hand to stave off disease when you can just remove the infected finger. Similarly, it would not be "necessary" to impose federal hard cap position limits *outside of the spot month* to prevent burdensome excessive speculation, when flexible position accountability levels have long served as and are an effective alternative to hard limits outside the spot month, and the Commission has not found otherwise. In contrast, exchanges have long relied on exchange-set hard cap limits to promote market integrity *in the spot month* for physically-delivered benchmark contracts in physical commodity markets. Thus, federal hard cap spot-month limits could be considered to be necessary to address inter-exchange or cross-market surveillance concerns but the Commission would still need to make an individualized, commodity-by-commodity necessity finding before imposing federal spot-month limits. As discussed in Part III of the letter filed with this Appendix, we do not believe that—especially in the initial phase of any new federal position limit regime—the Commission could make a similar necessity finding for federal non-spot-month limits.