



February 28, 2017

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

VIA ONLINE SUBMISSION

Re: Position Limits for Derivatives, RIN 3038-AD99 (Reproposal as published in the Federal Register on December 30, 2016)

Dear Secretary Kirkpatrick:

The Minneapolis Grain Exchange, Inc. (“MGEX” or “Exchange”) would like to thank the Commodity Futures Trading Commission (“CFTC” or “Commission”) for the opportunity to respond to the CFTC’s request for public comment regarding the Position Limits for Derivatives Reproposal (“Reproposal”)¹. MGEX has previously submitted comments on the CFTC’s Notice of Proposed Rulemaking regarding position limits for derivatives from prior Federal Register publications by letters dated March 28, 2011, February 10, 2014, August 1, 2014, January 22, 2015, March 30, 2015, July 13, 2016, and November 8, 2016.

MGEX is both a Subpart C Derivatives Clearing Organization (“DCO”) and a Designated Contract Market (“DCM”), and has been the primary marketplace for North American Hard Red Spring Wheat (“HRSW”) since its inception in 1881. Position limits have been a topic of much industry debate, particularly since passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”)². This Reproposal illustrates that the CFTC has carefully considered past comments and has made changes and modifications to position limits as presented in the Reproposal. MGEX thanks the Commission for its thoughtful consideration but respectfully submits that the Reproposal does not go far enough to address industry concerns.

It is vitally important that the cost of regulation not outweigh the benefit of the regulation. MGEX holds that several components of the Reproposal do not pass a cost-benefit

¹ See *Position Limits for Derivatives*, Reproposal, 81 Fed. Reg. 96,704 (Dec. 30, 2016).

² H.R. 4173, Pub. L. No. 111-203, 124 Stat. 1376 (July 21, 2010).

analysis and will add significant compliance cost to DCMs. A significant increase in regulation since passage of Dodd-Frank has led to significant market consolidation in several areas, most notably Futures Commission Merchants (“FCMs”) and contract markets. The dramatic increase in regulation and the high cost of compliance has driven entities to go out of business or to consolidate. Such market consolidation does not serve the larger derivatives markets well. As one of the only independent DCO/DCM remaining, MGEX believes it is very important to view the recent past with a critical eye to ensure that additional market consolidation caused by high regulatory compliance burdens does not continue to occur in the DCM space.

Therefore, MGEX has comments on the following topics in the Reproposal: I. Setting of limits and the definition of bona fide hedging; II. Recordkeeping requirements of DCMs; III. Reporting requirements for DCMs; IV. Tracking requirements for DCMs, V. Publishing requirements for DCMs; VI. Exemption procedures; VII. Wheat parity and the formulaic approach to setting limits; and VIII. Bona fide hedge exemptions.

I. Setting of Limits and the Definition of Bona Fide Hedging

MGEX contends that CFTC regulations, as currently applied to establishing position limits for physically settled agricultural products is working and does not require the type of overhaul outlined in the Reproposal. Furthermore, the legacy agricultural contracts have had a well-functioning position limits framework prior to Dodd-Frank and MGEX supports keeping this framework in place for the legacy contracts.

MGEX notes that action is required to address industry and market participants concerns regarding the definition of bona fide hedging (which is discussed below in VIII.). MGEX comments that 1.3(z) should be codified to align with current commercial hedging practices. However, addressing the definition of bona fide hedging does not require the extensive changes outlined in the Reproposal that increase recordkeeping, reporting, publishing, monitoring and exemption procedures for DCMs and applicants of hedge exemptions.

MGEX requests that both the setting of position limits and the definition of bona fide hedging be preserved as they are currently applied and interpreted by the CFTC. This preservation of current application can be accomplished through CFTC guidance. Alternatively, the scope of the position limits rulemaking should be significantly curtailed and to only include such provisions as needed to address industry concerns about the definition of bona fide hedging.

II. Recordkeeping Requirements of DCMs

The Reproposal adds significant recordkeeping requirements for DCMs engaged in the process of granting hedge exemptions. All three procedures outlined for DCM processed exemption applications, § 150.09, § 150.10, and § 150.11, include provisions for DCMs to “keep full, complete, and systematic records...of all activities relating to the processing

of such applications and the dispositions thereof”³. This requirement to keep all records is further elaborated to include all “records of **oral** and written communications between such [DCM]...and such applicant in connection with such application”⁴.

While MGEX believes the written recordkeeping requirements in the Reproposal are overly broad, MGEX is particularly concerned about the technological, financial and practical effects of recording and preserving **all oral** communications with hedge exemption applicants.

Acquiring the necessary technology to record all oral communications would involve significant investment in technology not currently used by MGEX in the course of business. Such technology may not be compatible with current systems and may result in a domino effect requiring multiple changes and subsequent investment in technological devices and internal procedures. MGEX is also concerned that after expending significant resources to comply with this requirement, technological or format changes on the CFTC’s end might require ongoing costs and investment. MGEX also questions the practical value of recording such oral communications and whether after all of the expense any reasonable benefit will be derived.

Moreover, MGEX is concerned that the practical effect of this requirement to record all oral communications will have a chilling effect on the free-flow of information between market participants and the Exchange. If market participants or Exchange staff believe that they are subject to unexpected second guessing or word by word dissection of their communications it could stifle frank and full communication. Additionally, in order to evaluate the merits of a hedge exemption request, information, often of a proprietary and confidential nature, needs to be communicated openly and freely by the applicant. If this oral communication is subject to a larger review it could hurt the marketplace.

MGEX requests that the Commission first revisit the value and necessity of the overreaching aspects of the recordkeeping requirements of the Reproposal. Additionally, MGEX requests that the Commission remove the recordkeeping requirement for oral communications between a DCM and hedge exemptions applicants from § 150.9 (b)(1)(ii); § 150.10 (b)(1)(ii); and § 150.11 (b)(1)(ii).

III. Reporting Requirements for DCMs

The Reproposal dramatically increases the reporting burdens for DCMs by adding weekly and monthly reporting requirements. MGEX’s commentary on this increase has been a common theme throughout the various position limits proposals. MGEX is concerned that reporting will merely be another recordkeeping and reporting burden. If a DCM wants to grant non-enumerated bona fide hedge exemptions such entity would be required to “submit to the Commission a report for each week as of the close of business on Friday

³ See Reproposal at 96975 and CFTC proposed regulation § 150.09(b)(1) (emphasis added), *See Also*, Reproposal at 96978 and CFTC proposed regulation § 150.10(b)(1), Reproposal at 96980 and CFTC proposed regulation § 150.11(b)(1).

⁴ See Reproposal at 96976 and CFTC proposed regulation § 150.9(b)(1)(ii), (emphasis added), *See Also*, Reproposal at 96978 and CFTC proposed regulation § 150.10(b)(1)(ii), Reproposal at 96980 and CFTC proposed regulation § 150.11(b)(1)(ii).

showing...information”⁵. In addition to this weekly report, DCMs “shall submit to the Commission, no less frequently than monthly, any report such [DCM]...requires to be submitted by an applicant to such [DCM]...pursuant to the rules...of this section.”⁶

These additional weekly and monthly reporting requirements involve gathering, compiling, and reporting a potentially significant amount of information at a cost to DCMs. Additionally, MGEX is concerned that the costs associated with these reports are difficult to fully quantify as the Reproposal does not establish guidelines for the submissions but states that such weekly and monthly reports should be submitted “as specified by the Commission on the Forms and Submissions page at www.cftc.gov”⁷. Furthermore, such submissions should use “the format, coding structure, and electronic data transmission procedures approved in writing by the Commission.”⁸

Since the Reproposal is not final, no guidance is available on the CFTC’s website regarding the format, coding, structure, or transmission procedures for these weekly and monthly reports which means the cost of compliance is unknown. However, DCMs, including MGEX, will need to establish additional internal procedures to collect the necessary information and will need to comply with unknown technical specifications. Different types of format or coding specifications can have substantial cost differentials for DCMs. The uncertainty of these costs is concerning for MGEX as is the reality that the format and reporting specifications are likely to change in the future, further increasing the costs to DCMs.

It is also important to note that there are numerous industry concerns regarding the definition of bona fide hedging and the limited examples of hedging that is enumerated (versus non-enumerated). It is vital that these other concerns be addressed otherwise the burdens of the recordkeeping requirements for the non-enumerated bona fide hedging position applications could be exacerbated by a larger reliance of industry participants on non-enumerated hedge exemptions. Such increased activity would place additional human and financial burdens on DCMs.

⁵ See Reproposal at 96976 and CFTC proposed regulation § 150.9 (c)(1) (Information required by § 150.9 (c)(1) include: (A) The date of disposition, (B) The effective date of the disposition, (C) The expiration date of any recognition, (D) Any unique identifier assigned by the designated contract market or swap execution facility to track the application, (E) Any unique identifier assigned by the designated contract market or swap execution facility to a type of recognized non-enumerated bona fide hedging position, (F) The identity of the applicant, (G) The listed commodity derivative contract to which the application pertains, (H) The underlying cash commodity, (I) The maximum size of the commodity derivative position that is recognized by the designated contract market or swap execution facility as a non-enumerated bona fide hedging position, (J) Any size limitation established for such commodity derivative position on the designated contract market or swap execution facility, and (K) A concise summary of the applicant’s activity in the cash markets for the commodity underlying the commodity derivative position; and (ii) The summary of any nonenumerated bona fide hedging position published pursuant to paragraph (a)(7) of this section, or revised, since the last summary submitted to the Commission.

⁶ See Reproposal at 96976 and CFTC proposed regulation § 150.9 (c)(2).

⁷ See Reproposal at 96976 and CFTC proposed regulation § 150.9 (c)(3)(i).

⁸ See Reproposal at 96976 and CFTC proposed regulation § 150.9 (c)(3)(ii).

These same weekly and monthly reports as well as their associated costs are also required for DCMs processing spread exemption applications⁹ and bona fide hedge exemptions for those enumerated circumstances outlined in § 150.11.¹⁰

MGEX requests that these weekly and monthly reports for bona fide hedging applications and exemptions be eliminated from the Reproposal. Alternatively, the CFTC should reduce the frequency of the reports to monthly and annually, respectively.

IV. Tracking Requirements for DCMs

One of the components of the weekly reports discussed above (in section III.) is for a DCM to include “any unique identifier assigned by the [DCM]...to track the application”¹¹ as well as “any unique identifier assigned by the [DCM]...to a type of recognized non-enumerated bona fide hedging position”¹² These provisions appear to require that unique identifiers be used by DCMs. Such a requirement to track, via unique identifier, both the application for a hedge exemption and the type of recognized position is concerning to MGEX.

This requirement could mean significant changes to clearing processes as well as surveillance programming used by DCMs. Tracking the application within a department is one thing, collating that information to market activity via software will entail programming costs and may be technologically impractical or prohibitively costly.

MGEX requests that the requirement as proposed to track the information outlined in § 150.9 (c)(1)(i)(D)-(E), § 150.10 (c)(1)(i)(D)-(E), and § 150.11 (c)(1)(i)(D)-(E) be eliminated. Alternatively, MGEX requests that the Reproposal be modified to explicitly allow for exchange discretion in the method of tracking the application and tracking the type of activity including allowing manual tracking.

V. Publishing Requirements for DCMs

If a DCM elects to process non-enumerated or spread hedge exemptions under § 150.9 and § 150.10 respectively, or certain enumerated exemptions in § 150.11, there are new publication requirements. For example, “After recognition of each unique type of derivative position as a non-enumerated bona fide hedging position, based on novel facts and circumstances, a [DCM]...shall publish on its Web site, on at least a quarterly basis,

⁹ See Reproposal at 96978 and CFTC proposed regulation § 150.10(c).

¹⁰ See Reproposal at 96979 and CFTC proposed regulation § 150.11 (c).

¹¹ See Reproposal 96976 and CFTC proposed regulation § 150.9 (c)(1)(i)(D), *See Also*, Reproposal at 96978 and CFTC proposed regulation § 150.10 (c)(1)(i)(D) (analogous provision for non-enumerated hedge exemptions), Reproposal at 96980 and CFTC proposed regulation 150.11(c)(1)(i)(D) (analogous provision for spread exemptions).

¹² See Reproposal 96976 § 150.9 (c)(1)(i)(E), *See Also*, Reproposal at 96978 and CFTC proposed regulation § 150.10 (c)(1)(i)(E) (analogous provision for non-enumerated hedge exemptions), and Reproposal at 96980 and CFTC proposed regulation § 150.11(c)(1)(i)(E) (analogous provision for spread exemptions).

a summary describing the type of derivative position and explaining why it was recognized as a non-enumerated bona fide hedging position.”¹³

MGEX questions whether this new publication requirement will be as beneficial to the industry as the CFTC believes. MGEX suspects it will cause confusion or conflict, and may even have the effect of increasing the overall cost of compliance.

Publishing summaries of hedge exemptions (either non-enumerated bona fide hedges or spread exemptions) will not serve the market well. When an applicant is applying for an exemption, proprietary and confidential information, including hedging strategy and trading strategy, is communicated by the applicant to the DCM. Such information is proper for a DCM to have in order to evaluate the application and make a determination on the exemption. However, publishing this information would be improper and potentially lead to market disruption. Those who apply for bona fide hedging exemptions are those commercial entities that qualify. Providing their trading information and/or ‘novel fact and circumstances’ that might warrant an exemption could improperly or even inadvertently provide commercial, non-commercial, or speculative market participants with proprietary or sensitive information.

It is also important to note that each contract is different and the level of information a party could distill from a summary might depend on the size of the market, the ratio of commercial/speculative parties, or other commercial realities of the contract. MGEX’s market for HRSW has significant participation of commercial entities and the information gleaned from publishing even general summaries might lead to unintended consequences, even disruption or manipulation of the market for HRSW.

It is possible for the summaries of hedge exemptions to provide less detail (and less proprietary information); however, such a practice could produce confusion or conflict in the marketplace. A market participant could see a summary posted and be confused as to why one exemption was granted while theirs was not. The DCM may have very strong reasons for granting one exemption and not another but due to proprietary or confidential information this may not appear on the website. Additionally, a party could see a summary posted and believe, erroneously, that conduct they wish to engage in should qualify under the same grounds as the summary. The DCM may disagree and deny the hedge exemption. Either of these scenarios leads to unnecessary conflict and confusion in the marketplace.

MGEX is also concerned that while the cost of complying with the requirement may not be initially excessive, creating the summaries and posting them to a web site does entail technological and personnel costs. Additionally, MGEX is concerned there is nothing in the regulations about phasing out information. Under a plain reading of the requirement, this information on hedge exemptions will need to be posted in perpetuity on a web site. These quarterly reports are in addition to the weekly and monthly reports being created and submitted to the CFTC on hedge exemptions (see III.).

¹³ See Reproposal at 96975 and CFTC proposed regulation § 150.9(a)(7), See *Also*, Reproposal at 96978 and CFTC proposed regulation § 150.10(a)(7) (analogous provision for spread exemptions).

MGEX requests that the requirements in § 150.09 (a)(7) and § 150.10 (a)(7) to publish summaries of hedge exemptions be eliminated. Alternatively, MGEX requests that such information can be removed from the website at the discretion of the DCM. Moreover, the regulations should be modified to include clear and broad latitude for DCMs in the content of any posting.

VI. Exemption Procedures

The Reproposal outlines four different sections for different types of hedge exemptions: § 150.7 for anticipatory hedge exemptions; § 150.9 for non-enumerated bona fide hedge exemptions; § 150.10 for spread hedge exemptions; and § 150.11 for “bona fide hedges for unfilled anticipated requirements, unsold anticipated production, anticipated royalties, anticipated service contract payments or receipts, or anticipatory cross commodity hedge positions.” Three of these hedge exemption processes, § 150.9, § 150.10, and § 150.11 are all processed by DCMs (or Swap Execution Facilities) while anticipatory hedge exemptions are handled by a different procedure and are instead submitted to the CFTC directly under § 150.7.

This parallel structure is confusing, unnecessary, and burdensome. In particular, the distinction between those hedge exemption applications that would be processed under § 150.7 by the CFTC and § 150.11 by a DCM is parsed thinly. § 150.7 concerns anticipatory hedges whereas § 150.11 concerns other ‘anticipated activities.’ There is no need to establish two separate paths for similar, approved, bona fide hedging. Market participants will need to be monitoring and submitting information into two separate processes. Additionally, MGEX is concerned that in order for a DCM, to be aware an applicant has submitted a request to the CFTC under § 150.7, the DCM will need to request the same information be submitted to them. This would result in market participants submitting information twice, adding time and cost of compliance. DCMs are in the best position to evaluate what conduct is a bona fide hedge in the relevant sector of the industry and in the particular contract in question.

MGEX requests that the Commission revise § 150.7 to allow for DCMs to process and grant anticipatory hedge exemptions consistent with § 150.9, 150.10, and 150.11 (subject to the changes to these sections outlined in this and other industry letters).

It is also important to note that in addition to two parallel structures, there is also a potentially problematic review process by the CFTC for DCM granted hedge exemptions: “The Commission may in its discretion at any time review any non-enumerated bona fide hedging position application submitted to a [DCM]”¹⁴ Under this authority the CFTC would engage in a process of review:

“(2) If the Commission preliminarily determined that any non-enumerated bona fide hedging position application...presents a novel or complex

¹⁴ See Reproposal at 96976 and CFTC proposed regulation § 150.9(d)(1), See Also, Reproposal at 96978 and Proposed CFTC regulation § 150.10(d)(1)-(4) (analogous provision for spread exemptions), Reproposal at 96980 and CFTC proposed regulation § 150.11 (d)(1)-(3) (the provisions of § 150.11 for certain enumerated positions are analogous to but slightly different process than § 150.9).

issues...or that an application or the disposition thereof by such [DCM]...is potentially inconsistent with section 4a(c) of the Act and the general definition of bona fide hedging position in § 150.1, the Commission shall: (i) Notify such [DCM]...and the applicable applicant...(ii) Provide them with 10 business days in which to provide the Commission with any supplemental information. (3) The Commission shall determine whether it is appropriate to recognize the derivative position...(4) If the Commission determine that disposition of such application is inconsistent...the Commission shall notify the applicant and grant the applicant a commercially reasonable amount of time to liquidate the derivative position or otherwise come into compliance.”¹⁵

This process entails the CFTC second-guessing the actions of the DCM and potentially requiring a market participant to unwind certain positions. This second-guessing calls into question the exchange authority and a market participant’s reliance on that authority. This in turn, could lead to confusion and ambiguity for market participants. Additionally, the requirement to unwind positions could potentially be very disruptive to the market.

MGEX requests that clear deference be codified to DCM decisions regarding the granting of hedge exemptions. The standard to overturn any DCM decision must be significantly high so as to provide certainty to the marketplace. Relatedly, any CFTC decision to overturn an exemption and require immediate unwinding or liquidation of positions should only occur if there is a finding that the positions held are causing market disruption or market manipulation. Furthermore, an order to unwind positions should not occur if it would lead to potential market disruption.

VII. Wheat Parity and the Formulaic Approach to Setting Limits

The Commission has adopted a formulaic approach for setting position limits. Specifically, “each such limit shall be based on 10 percent of the estimated average open interest in referenced contracts...provided however, the Commission may determine not to change the level of the single-month limit or the all-months-combined limit.”¹⁶ As MGEX and other industry groups have repeatedly called for in prior comment letters, it is critical that the CFTC maintain parity among the three U.S. wheat contracts: CBOT Wheat, KCBT Hard Winter Wheat, and MGEX HRSW. Currently, all three U.S. wheat contracts share an identical single month and all months combined limit of 12,000 contracts.

The Reproposal sets out a partial parity approach whereby the Commission has used its discretion to allow MGEX and KCBT wheat to have a higher limit than the normal formula would allow. MGEX sincerely thanks the Commission for its responsiveness on this topic. While full parity is the preference of MGEX, MGEX is appreciative of the use of the Commission’s discretion.

However, MGEX is concerned for the future of the HRSW contract. MGEX’s HRSW contract is over 135 years old and its future is just as important as its past. Under the

¹⁵ See Reproposal at 96976 and CFTC proposed regulation § 150.9(d)(2)-(4) (this text has been edited via ellipses for length).

¹⁶ See Reproposal at 96968 and CFTC proposed regulation § 150.2 (e)(4).

Reproposal regime for single-month and all-months-combined the Commission will “no less frequently than every two calendar year...fix the level, for each referenced contract”¹⁷ MGEX’s HRSW is a core referenced futures contract¹⁸ subject to this review every two years. MGEX is concerned that the discretion being used now by the Commission will not be continued in the future. For an important agricultural reference contract that has the largest underlying production and that is by far the largest wheat class in North America, MGEX is concerned about this uncertainty. Therefore, the formulaic approach should not apply to the wheat contracts. There is a proven history with parity among the three class’ position limits that has shown such parity is appropriate and well-functioning. However, in the event the Commission finds a formulaic approach to be necessary the method for determining limits should not be limited to open interest. Alternate methods, such as limits based on crop production should be permitted as production better reflects the underlying physical product and associated risks of physically delivered agricultural products.

MGEX requests full parity among the three wheat contracts. Alternatively, MGEX requests that wheat parity or the partial parity position be more permanently recognized by the Commission to lend better certainty and reliability to the market participants in the wheat contracts. It is valuable to recognize that many participants in one of the contracts are also participants in the other contracts and that the three wheat classes are an interconnected ecosystem.

VIII. Bona Fide Hedge Exemptions

MGEX urges the CFTC to consider those comments submitted by commercial end-users and market participants with regard to what activities should be characterized as bona fide hedges. It is evident that the definition of what constitutes a bona fide hedge is of paramount importance to the everyday market participants that rely on the futures markets to hedge commercial risk, whether that risk is based on price, time, anticipated future production, or otherwise. CFTC regulation 1.3(z), currently applicable to trading in legacy agricultural contracts like HRSW, needs to be codified to align with and include commercial hedging practices.

Additionally, in the event a speculator attempted to improperly abuse a bona fide hedge exemption there are sufficient safeguards to prevent this activity. Moreover, all market participants are subject to the same rules regarding disruptive trading practices and market manipulation that could also be used to investigate and discipline a party trying to ‘game the system’. The Congressional mandate to the CFTC in establishing broader federal position limits was to curb excessive speculation, and not inhibit legitimate risk management activities.

In addition to the definition of bona fide hedging, there are numerous other concerns being raised by commercial end-users regarding the Reproposal. MGEX supports the interests

¹⁷ See Reproposal at 96967 and CFTC proposed regulation § 150.2 (e)(4).

¹⁸ See Reproposal at 96967 (HRSW or MWE is listed in the chart as a core referenced contract).

of the industry and these comments, in particular comments being made about the five-day rule and anticipatory hedging.

Thank you again for the opportunity to comment, and please feel free to contact MGEX with any further questions.

Sincerely,

A handwritten signature in blue ink that reads "Emily Spott". The signature is written in a cursive style with a large initial "E" and a small "Spott" at the end.

Emily M Spott
Associate Corporate Counsel

cc: Mark G. Bagan, Minneapolis Grain Exchange, Inc., President & CEO
Layne G. Carlson, Minneapolis Grain Exchange, Inc., Chief Regulatory Officer