INSTITUTE FOR AGRICULTURE AND TRADE POLICY

Secretary to the Commission February 28, 2017
Commodity Futures Trading Commission (CFTC) (Commission)
Three Lafayette Center
1155 21st Street NW
Washington, DC 20581

17 CFR Parts 1, 15, 17, 37, 38, 140, 150 and 151
RIN 3038–AD99

Re-proposed rulemaking: Position Limits for Derivatives[1] (Re-proposal)

Submitted electronically at http://comments.cftc.gov

General Comment

The Institute for Agriculture and Trade Policy (IATP)[2] appreciates this opportunity to comment on the Commission's above captioned Re-proposal of the December 2013 position limits rule, following the Supplemental Notice (SN) of rulemaking on certain exemptions and guidance to position limits. Our concerns, first expressed in a July 13, 2016 comment on the SN[3], about the capacity of the CFTC to implement and enforce the position limits rule under the conditions of current and foreseeable regulatory budget austerity[4] --relative to the huge increase in the variety and number of contracts under the Commission's surveillance and enforcement—have grown. We urge that the incoming Chairman follow Chairman Timothy Massad's example in making the case to Congress to provide a budget adequate to implement and enforce the CFTC's statutory obligations.[5]

While IATP disagrees with some of the new definitions and exemptions in the Re-proposal, we ask that the Commission approve a revised version of the Re-proposal soon after a new Chairman and Commissioners have been nominated and confirmed. At this point in the remarkably contentious struggle to develop a position limits regime under the authority of the Dodd Frank Wall Street Reform and Consumer Financial Protection Act (Dodd Frank), it is imperative to establish a position limits regime, even a less than optimal one, rather than revert to the non-regulation of exempted commodity derivatives contracts and of swaps under the Commodity Futures Modernization Act. If and when swaps dealers report swaps trading data to data repositories, according to a template of common data elements, there will be a better data basis for setting both spot month and non-spot month limits, and for the Commission to determine whether the exchange granted exemptions to position limits are circumventing the statutory objectives of the Commodity Exchange Act (CEA).

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We strongly discourage the Commission to refrain from or delay rulemaking in anticipation that any rulemaking will be subject to one or more of the current regulatory “reform” bills before Congress. One of these bills would repeal rules or even sets of rules—not based on the statutes that authorize the rules— but to realize a reduction of regulatory costs to industry under so-called “cut-go” procedures.[6]

Nullifying regulations authorized by one statute and forbidding “substantially similar” rulemaking without amending the authorizing statute is highly contentious and unsettled legal ground. We urge the Commission to finalize rulemakings under the authority of Dodd Frank and the CEA, rather than not finalize in anticipation of the enactment of regulatory “reform” legislation and the result of lawsuits about such legislation. Even the placement of “regulation monitors” by presidential executive order in the CFTC to make recommendations about which Commission regulations to repeal, regardless of their statutory authority, will have to make their case based on an analysis of finalized rules.[7] The Commission must not be intimidated by such monitors from initiating and completing rulemakings, and implementing and enforcing rules under the CEA and Dodd Frank authorities.

IATP is pleased that the CFTC has rejected the industry argument that the Commission must produce ex ante quantification of all costs and benefits associated with the position limit rule before it can finalize the rule and comply with Section 15 of the CEA (FR, 96842-96843). Likewise, IATP agrees with the Commission that position limits are a necessary tool to prevent and reduce excessive speculation by non-commercial hedgers in their hedging activities. (FR 96842)

Remarks on Major Features of the Re-proposal

IATP agrees with three main features of the Re-proposal:

> Specify limits on 16 contracts in addition to the nine existing legacy contracts (i.e., a total of 25); (2) extend the application of these limits beyond futures and futures-equivalent options to all commodity derivative interests, including swaps; and (3) extend the application of these limits across trading venues to all economically equivalent contracts that are based on the same underlying commodity. (FR 96850-96851)

It is very desirable that the number of contracts covered by the position limits regime expand for at least two reasons; 1) to enable commercial hedgers in those formerly exempted contracts to more effectively hedge price risks in those contracts and economically equivalent ones; 2) to enable commercial hedgers to better understand price formation co-movements among covered contracts that are position limited but that they are not hedging.

Furthermore, the Commission must extend position limits to swaps contracts, which take advantage of the public and near real time futures and options price reporting, while providing no near real time price information to enable price discovery for commercial hedgers. However, this necessary extension of the position limits regime has been severely impeded by the failure of swaps dealers to agree with the Commission on standardized data reporting elements to enable commodity swaps reporting. As of October 28, 2015, the Commission no longer requires exchanges and swaps data repositories to report Over the Counter (OTC) commodity swaps trading for the CFTC Weekly Swaps Report.[8]

The longer the Commission delays swaps dealer and major swaps participant compliance with the swaps reporting requirement, the less of the commodity derivatives market data universe will be available for the Commission's timely and comprehensive surveillance, including for purposes of implementing and enforcing the position limits regime. The Commission has rightly accused Deutsche Bank of multiple swaps reporting violations in non-commodity asset classes, since such reporting failures may mask default risks that could cascade into the U.S. financial system.[9] While the commodity swaps market is not so large that commodity swaps defaults could pose systemic risks for Systematically Important Financial Institutions, such defaults could certainly cause widespread damage to the commercial hedgers who currently can only risk manage prices based on what is reported of futures and options trading.

There is no well-founded legal or economic reason why commodity swaps dealers and major swaps participants must not comply with CFR Parts 43 and 45, as the Commission has required of Deutsche Bank. There is no sound legal or economic reason why the Commission cannot adapt the compliance tools it has used for non-commodity swaps reporting violations to commodity swaps reporting, if swaps dealers and major swaps participants continue to resist agreement with the Commission on standardizing near real time reporting of commodity swaps.

Comments on the Proposal to Amend the Definition of Bona Fide Hedging and Proposed Rules Related to Recognition of Bona Fide Hedging Positions by Exchanges and Swaps Execution Facilities

In IATP's comment on the SN, we have stated our criticisms of the amended definition of bona fide hedging requested by non-commercial market participants to enable exchanges to determine which swaps transaction to exempt from position limits.[10] We not repeat those criticisms here in detail. We note, however that by consenting in the Re-proposal to the demands of swaps dealers that they be granted the bona fide hedging exemption from position limits currently applied only to commercial hedgers, the Commission has given away a critical mass of regulatory authority for no apparent gain. By re-defining bona fide hedging such that exchanges may grant it to any swaps dealer or major swaps participant, exchanges and SEFs will get more SD and MSP transactions, but there is no guarantee that the Commission will get the standardized swaps data it requires, to help determine whether the Commission should revoke the delegated authority of the exchanges to grant the exemptions.

At least in terms of the Re-proposal, we do not see where the Commission has gained any degree of commodity swaps reporting compliance that would enable it, and indeed the public, to judge whether extending the bona fide hedge exemption to non-commercial traders will enable realization of the Dodd Frank and CEA objectives. To repeat a comment on the Commission's ability to supervise effectively its delegation of authority to exchanges to determine exemptions from position limits for swaps transacted for non-enumerated bona fide hedging and anticipatory hedging: "The Commission is confident that its "long experience" in supervising bona fide hedging exemptions in the futures and options markets, through regulatory enforcement reviews, can be readily applied to the supervising of exchanged granted exemptions for swaps from position limits (FR 38469, footnote 126)." This long experience of the Commission in supervising exchange granted exemptions in futures and options will be of little use in supervising exemptions granted to swaps dealers and major swaps participants that continue to avoid reporting their swaps trade data in a standardized, complete, accurate and near real time format, as is required of futures and options traders.

General Comment on Appendix I: Review of Economic Studies

The CFTC staff summarized its review of 244 studies (Appendix I- Review of Economic Studies, FR 96897), dismissing most of them as either lacking in statistical rigor, not leading to a consensus about whether excessive speculation existed in commodity markets or not demonstrating ex ante or ex post the impact of position limits to prevent or diminish excessive speculation. Remarkably, the summary did not include any reflection on why purportedly rigorous models of the economic profession failed to forewarn regulators about the statistical harbingers of the major financial institution default cascades of 2007-2009. Mathematical and methodological rigor of economic modeling, particularly by Commission-affiliated economists, is portrayed as the final arbiter of whether Commission monitored position limits are "necessary" as a Dodd Frank mandated policy tool to achieve the objectives of the CEA. (FR, 96916).

However, as Andrew Haldane, chief economist of the Bank of England recently stated, the economic profession continues to do a poor job of factoring the irrational into its modeling[11], including, I would add, the irrationality of market participants who advocate for more market self-regulation according to high-level principles so soon after the immediate past failure of self-regulation. It is, for example, shocking to read that the CFTC accepts the Chicago Mercantile Exchange's explanation of wide and prolonged futures and spot market price divergence in its wheat contract as a simple matter of CME wheat contract design failure: "When CME revised its wheat contract, this price divergence dissipated" (FR 96917) The CFTC is quick to dismiss the U.S. Senate report on excessive speculation in the wheat market as anecdotal and without statistical rigor: " These reports, which include factual recitation and anecdotal evidence, contain no models or methods that can be audited by economists." (FR 96917) In this review, only a natural science like replication of data processed according to the terms of a model provides valid proof of excessive speculation in the Review.

But the CFTC Review of Studies is quick to accept the contract design price divergence explanation presented by the CME and its academic cohort. (FR 96917). Broader institutional studies, even when demonstrated with CFTC data showing the nearly 70 percent dominance of non-commercial investors in the wheat contract are dismissed, e.g. including study by Ann Berg et al: "To sum up, the birth of massive non-commercial positions appears to be driven by the growth of commercial players and the expansion of international markets, as well as 'financialisation', which entails greater access to finance through new technologies. The growth of non-commercial positions, and in particular long passive investments (index investing), was supported by expansionary monetary policies (and cheap credit) that have helped to improve access to finance and to promote massive changes across asset classes."[12] Understanding the structural change in market players, trading practices, technology and response to regulation might assist the CFTC to better understand price distortions and excessive speculation, than a review of academic articles, not a few of which are sponsored by the beneficiaries of regulation lite or non-regulation.

An economist seeking as better way to train post-crisis economists, remarked, "Currently, most economists are not selected for their ability to, or trained in how to "choose" an appropriate model, or otherwise relate a model to policy. Doing this requires knowledge of a wide range of models, historical knowledge, and institutional knowledge. They are trained almost entirely to produce models. The other ability they must learn on their own."[13] Unfortunately, many economists do not learn how to think outside the box of the modeling for which they are professionally rewarded both within and without academe. The CFTC should consider adding to its staff and advisors analysts of structural and technology changes in markets and financial institutions to determine what regulatory instruments might be adequate to keep individual investment objectives of market participants from aggregating positions that might distort prices or even lead to counterparty default cascades.

Conclusion

IATP thanks the Commission for this opportunity to comment on the Re-proposal. If the forces of regulatory "reform" succeed in preventing the finalization of the position limits regime and other rulemakings, we hope that Commission staff will reach out to IATP and other organizations to work cooperatively to manage the risks to well-functioning markets of the "reform" and regulatory budget austerity environments.

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[1] http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2016-29483a.pdf

[2] IATP is a U.S. nonprofit, 501(c)(3) nongovernmental organization, headquartered in Minneapolis, Minn., with an office in Washington, D.C. Our mission states, "The Institute for Agriculture and Trade Policy works locally and globally at the intersection of policy and practice to ensure fair and sustainable food, farm and trade systems." To carry out this mission, as regards commodity market regulation, IATP has participated in the Commodity Markets Oversight Coalition (CMOC) since 2009, and the Derivatives Task Force of Americans for Financial Reform since 2010. IATP has submitted several comments on U.S. Commodity Futures Trading Commission rulemaking, and on consultation papers of the International

Organization of Securities Commissions, Financial Stability Board, the European Securities and Markets Authority, and the European Commission's Directorate General for Internal Markets (now Directorate General for Financial Markets).

[3]

https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=60951&SearchText=Institute%20for%20Agriculture%20and%20Trade%20Policy

[4] Richard Hill, "SEC, CFTC Funding Flat in Senate Bill," BNA Securities Law Daily, June 16, 2016. https://www.bna.com/sec-cftc-funding-n57982074254/

[5] E.g. "Testimony of Chairman Timonty Massad before the U.S. House Appropriations Committee, Subcommittee on Agriculture, Rural Development, Food and Drug Administration and Related Agencies." February 10, 2016. http://www.cftc.gov/PressRoom/SpeechesTestimony/opamassad-42

[6] E.g. "Searching for and Cutting Unnecessarily Burdensome Rules Act," (H.R. 998, "SCRUB Act"), Title II. February 231, 2017. https://www.govtrack.us/congress/bills/115/hr998/text

[7] David Shephardson and Steve Holland, "In sweeping move, Trump puts regulation monitors in agencies," Reuters, February 24, 2017. http://www.reuters.com/article/us-usa-trump-regulations-idUSKBN1631NV

[8] http://www.cftc.gov/MarketReports/SwapsReports/Archive/index.htm

[9] "CFTC Charges Deutsche Bank AG With Multiple Swaps Reporting Violations, Related Supervision Failures and Violation of a Prior CFTC Order," August 18, 2016. http://www.cftc.gov/PressRoom/PressReleases/pr7430-16

[10]

https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=60951&SearchText=Institute%20for%20Agriculture%20and%20Trade%20Policy

[11] Phillip Inman, "Chief economist of the Bank of England admits errors in Brexit forecasting," *The Guardian*, January 5, 2017. https://www.theguardian.com/business/2017/jan/05/chief-economist-of-bank-of-england-admits-errors

[12] Ann Berg, "Price Formation in Commodity Markets: Financialization and Beyond," Center for European Policy Studies, 2013.," Figure 33: "Wheat futures contract by percentage of open interest," 66 and 73. https://www.ceps.eu/system/files/commodtfr.pdf

[13] David Collander, "The Economics Profession, the Financial Crisis and Method," Middlebury College Economics Discussion Paper, No.10-38, October 2010, 8. http://sandcat.middlebury.edu/econ/repec/mdl/ancoec/1038.pdf