BETTER MARKETS

February 28, 2017

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

Re: Position Limits for Derivatives (CFTC RIN: 3038-AD99)

Dear Mr. Kirkpatrick,

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

INTRODUCTION

Physical commodity producers and purchasers grow the food we eat, generate the power in our homes, manufacture the vehicles we travel in, produce the fuel we need, and otherwise directly enable not just modern life, but also a rising standard of living. It is not an overstatement to say that commodity markets are essential for every man, woman, child, and business in the United States. In addition, excessive speculation and manipulation in the commodity markets can contribute to seismic instability in our financial system, increasing the likelihood of financial crashes that degrade the quality of life for all Americans. That is what is at stake when regulating these markets and why it is vital to regulate them properly.

In the years leading up to the 2008 financial crisis, commodity markets experienced a sea change in both market structure and deregulation. As the culmination of a series of deregulatory measures that had already significantly eroded position limits and other traditional market protections, the heavily criticized 2001 Commodity Futures Modernization Act opened a Pandora's Box of deregulated derivatives trading. It spawned a series of commodity market crises in a relatively short period of time. The Amaranth Natural gas episode in 2001, the unprecedented speculative volatility of oil prices during 2008, the

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

Flash Crash of 2010, and of course the financial crisis and economic crash of 2008 have all illustrated the need for a new and effective regulatory structure in commodities derivatives.

While the Commission has made great strides in implementing the new swaps regulatory framework under the Dodd-Frank Act, it has failed to make similar progress in the critical area of position limits, which are critical to preventing excessive speculation. The current debate over the role of speculation in commodity markets, and the role of regulators in containing it, has been going on for nearly 100 years,[2] and the congressional mandate to prevent excessive speculation has existed for nearly as long. While the scope and degree of enforcement has varied significantly over the years, regulators have repeatedly recognized the need to limit speculative positions in response to nearly every market crisis since the 1920's. In the wake of the largest sustained disruption to commodity markets in their volatile history, speculative position limits have never been more essential.

The Re-Proposal implicitly acknowledges the ongoing and urgent need for additional regulatory reforms to implement the Commodity Exchange Act limits on excessive speculation. However, it falls far short of accomplishing the intended goal of restoring and protecting a stable, functional market utility for the benefit of physical commodity producers and consumers. In a series of proposals over the years, the Commission has added qualifications and exemptions that greatly diminish the effectiveness of its approach. This Re-Proposal represents the most recent and most egregious departure from Congress's language and intent and the Commission must overhaul it.

The Re-Proposal has crafted Position Limits that are so high, and so narrowly applied, that they would fail to meaningfully prevent or reduce excessive speculation outside of the most egregious cases of manipulation. They would also fail to capture particularly harmful types of speculation such as commodity index trading, despite the fact that Congress clearly empowered the Commission to place additional limits on any "group or class of traders." Additionally, the Re-Proposal impermissibly reduces the Commission's ability to regulate excessive speculation in the commodity markets by delegating some of its paramount duties and authorities to the industry's for-profit exchanges. Specifically, the Re-Proposal purports to delegate to designated contract markets (DCM) and swap execution facilities (SEF) the authority to recognize non-enumerated bona fide hedges (NEBFH) or enumerated anticipatory bona fide hedges (ABFH), as well as to exempt from CFTC position limits certain spread positions. These provisions are baseless and fundamentally at odds with the statutory mandate of limiting speculation.

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

While this comment will cover the substantive issues above, we remind the Commission that exhaustive treatment of these and other related topics is contained in previous comment letters submitted by Better Markets.[3] In addition, various other public interest groups, academics, and commodity producers and end-users have provided much thoughtful input on an array of issues arising from and related to the Proposed Rule[4].

Unfortunately, after all this time and all this work, the integrity, stability, and utility of the commodity markets will not be adequately promoted and protected by this Re-Proposal as currently drafted.

COMMENTS

1. The Commission Must Craft a Rule that Achieves All of Congress' Goals and Addresses More than Just Market Manipulation.

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

(i) to diminish, eliminate, or prevent **excessive speculation**;
(ii) to deter and prevent market manipulation, squeezes, and corners;

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3 While this letter responds specifically to the Re-Proposal, it builds upon the information contained in the following comment letters filed by Better Markets, which are incorporated hereby as if fully set forth herein. *See* Better Markets Comment Letter, "Position Limits for Derivatives," (Mar. 28, 2011), *available at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=34010; Better Markets Comment Letter, "Position Limits for Futures and Swaps," (Jan. 17, 2012), *available at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=50076; Better Markets Comment Letter, "Aggregation, Position Limits for Futures and Swaps," (Jun. 29, 2012), *available at* *http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=58292*; Better Markets Comment Letter, "Aggregation of Positions" (Feb. 10, 2014), *available at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=59715; Better Markets Comment Letter, "Position Limits for Derivatives," (Feb. 10, 2014), *available at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=59716; Better Markets Comment Letter, "Position Limits for Derivatives and Aggregation of Positions," (March 30, 2011), available at https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=60325&SearchText=better%20markets; Better Markets Comment Letter, "Position Limits for Derivatives: Certain Exemptions and Guidance," available at https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=60928&SearchText=better%20markets .

4 *See* ATA Comment Letter (Apr. 23, 2010), *available at* *http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=17197&SearchText*; Delta Airlines Comment Letter (Mar. 28, 2011), *available at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=33989; Americans for Financial Reform Comment Letter (Mar. 28, 2011), *available at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=34046; University of Maryland School of Law Comment Letter (Mar. 28, 2011), *available at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=33850; Commodity Markets Oversight Coalition Comment Letter (Aug. 31, 2011), *available at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=48123.

(iii) to ensure sufficient market liquidity for bona fide hedgers; and
(iv) to ensure that the price discovery function of the underlying market is not disrupted.[5]

It is clear from these explicit criteria that Congress sees four distinct threats to commodity markets, and that **each** is to be addressed in the comprehensive imposition of position limits by the CFTC. Judged by these criteria, the Position Limits Rule, as proposed, is largely a failure. Specifically, the Commission has described, set, and justified position limits that **exclusively** aim to prevent extraordinary instances of market manipulation[6], while failing to address non-manipulative excessive speculation, insufficient liquidity, or impaired price discovery.

The extraordinary disruptions experienced during the Hunt Brothers manipulation of the silver market or Amaranth's cornering of the Natural Gas market (the two demonstrative episodes used by the Commission to show the necessity of Position Limits) contained all four elements listed above, but any manipulation on such a huge scale would of course disrupt the orderly function of markets in multiple ways. Indeed, excessive speculation, insufficient liquidity, and impaired price discovery function often accompany market manipulation, but they can independently disrupt markets even absent manipulative activity.

Manipulation in all cases is explicitly prohibited in the Commodity Exchange Act, and Dodd-Frank was significant largely because it expanded the Commission's authority to prohibit **other** disruptive trading practices.[7]

In short, position limits were intended to do much more than help the Commission combat market manipulation. They were crafted to be the means of reducing the burden on interstate commerce that specifically arises from excessive speculative activity. While speculative activity (excessive or not) conducted with an aim to manipulate prices would undoubtedly put a burden on commerce, it is only one example of such activity. The burden caused by the cumulative effect of smaller speculators acting in tandem may be just as significant—and potentially much greater than—that of a single actor with manipulative intent.

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5 (*emphasis added*) CEA section 4a(a)(3); 7 U.S.C. 6a(a)(3).

6 As discussed below, it is questionable whether the Proposed Rule, as written, even adequately addresses this single criterion. For example, the Proposed Rule would not prevent or deter the market manipulation conducted in the 2011 Parnon Energy case, where the firm used the physical market to manipulate the settlement price of their futures position. http://www.cftc.gov/PressRoom/PressReleases/pr6041-11

7 Manipulation: CEA section 9, Disruptive Trading Practices: Dodd-Frank Act § 747 *See also* Better Markets Comment Letter, "Antidisruptive Practices Authority,"(Jan. 3, 2011 available at http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=42710&SearchText=better%20markets.

Congress clearly intended position limits to be designed to limit a variety of harmful activities, including outright manipulation **as well as those instances of excessive speculation that may not be intentionally manipulative**. In the preamble to the Proposed Rule, the Commission acknowledges this point, yet fails to propose position limits that could reasonably be expected to address such activity.

Position Limits that effectively limit the threat of excessive speculation must be set at a significantly lower level than that which would limit market manipulation alone. The limits must account for the cumulative effect of identical speculative positions that may not be excessive on an individual basis but constitute excessive speculation in the aggregate[8].

2. **Commodity Index Funds Must Be Subject to Strict Speculative Position Limits.**

   A. The Commission has explicit statutory authority in this area.

The Commission is empowered with explicit statutory authority to impose position limits on commodity index traders (CITs). The Dodd-Frank Act amended the CEA to **strengthen** aggregation requirements by applying them to contracts in the same underlying commodity and to economically related contracts, across all venues. Additionally, in connection with the position limits set out in Section 737 of the Dodd-Frank Act, Congress included the following provision:

> "[S]uch limits upon positions and trading shall apply to positions held by, and trading done by, two or more persons acting pursuant to an expressed or implied agreement or understanding, the same as if the positions were held by, or the trading were done by, a single person."[9]

It is clear that the large universe of CITs, which trade en masse with respect to an explicit programmed common buy/sell strategy, satisfy this provision.

   B. The Commission's claimed "lack of experience" in setting such limits is no justification for inaction.

There is no possible justification, nor has the Commission provided a justification, for exempting CITs from the proposed Position Limits. In the preamble to the vacated Position Limits rule, "Vacated Part 151," the Commission explains that it lacks sufficient experience in applying limits to a "group or class of traders" and therefore would not be setting such limits in the rule.[10] But, **Congress did not condition the development of new**

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8 *See* Better Markets' comment letter regarding Aggregation of Positions, submitted February 10th, 2014, for an in-depth treatment of this issue.

9 7 U.S.C. § 6a(a)(1).

10 Vacated Part 151 Final Rule, 11/18/11 – FR71657: "Historically, the Commission has applied position limits to individual traders rather than a group or class of traders, and does not have a similar level of experience with respect to group or class limits as it has with position limits for individual traders. Therefore, the Commission believes more analysis is required before the Commission would impose a

and necessary regulation on whether the Commission has "experience" in setting such limits. The Commission's position cannot possibly be valid, as it would in effect prevent the CFTC from ever promulgating new rules to implement new statutory requirements, for lack of prior experience. This is an unacceptable abdication of responsibility and a violation of the statutory mandate given to the Commission.

C. Subjecting CITs to Position Limits Would Help Diminish, Eliminate, or Prevent Excessive Speculation.

Further, it is clear that the application of position limits to CITs and the swaps and futures offsetting the risks of these traders would help achieve the statutory goals established by Congress. Comprehensive application of Position Limits to CITs alone would meaningfully combat excessive speculation and offer at least a partial remedy for the substantial inadequacies of the Proposed Rule.

The existing level of speculation in the commodity markets is excessive—and in recent times has approached crisis levels. Yet, after more than five years of observation and deliberation, the Re-Proposal would set speculative position limits so high and narrowly that they would fail to diminish, eliminate, or prevent any excessive speculation that is not incidental to extraordinary market manipulation. In fact, very few traders would exceed the limits as currently proposed.

It is therefore all the more important to subject the CITs to the Position Limits to achieve any meaningful curbs on excessive speculation. CIT positions would collectively exceed even the overly generous current limits if appropriately aggregated according to the statute.[11] Bringing the **class** of CITs within the scope of speculative Position Limits, even at their currently exorbitant levels, would therefore produce a meaningful reduction of excessive speculation and thereby promote the statutory goals.

D. Index Funds Must Be Specifically Included in the Definition of Reference Contract.

The single most straightforward and commonsense way for the Commission to strengthen the Proposed Rule and to better fulfill the letter and spirit of the Congressional mandate, is to include "commodity index contract" in the definition of "reference contract." Initially, the definition of "reference contract" in § 150.1 of the rules governing position limits included "commodity index contracts." However, without any justification, the Commission later reversed course and deleted "commodity index contracts" from the definition of "reference contract."

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separate position limit regime, or establish an exemption, for a group or class of traders, including CITs. The Commission welcomes further submissions of studies to assist in subsequent rulemakings on the treatment of various groups or classes of speculative traders."

11 "...this formula would result in levels for non-spot month position limits that are high in comparison to the size of positions typically held in futures contracts. Few persons held positions over the levels of the proposed position limits in the past two calendar years," FR 75731.

We urge the Commission to reconsider the ample evidence it has received in studies, comments, testimonies, and reports demonstrating the harmful and disruptive effects of CITs on the futures market. As Better Markets and many others have demonstrated, commodity index contracts are enormously influential within the futures markets, and must be considered a "reference contract" and brought within the scope of the rule.

3. The Proposed Position Limits Are Too High To Prevent Excessive Speculation.

Even in a market where producers and consumers are constantly mismatched, the level of speculation required to provide liquidity would never exceed 50 percent of the market (the level at which each and every trade between producers and consumers is intermediated by a speculator). In a more realistic market, the optimal level of speculation will be considerably lower, and this is borne out by the fact that traditionally speculation has hovered between 15 percent and 30 percent of market share (measured in open interest).

If the Rule is to diminish the excessive speculation that damages the commodity markets, it must ensure that position limits are set at a level that will restore this historical balance. Without the access to data that the Commission enjoys, it is difficult to pinpoint the precise limits that are necessary to address this problem.[12]

Nevertheless, it is possible to draw some general conclusions about the negligible impact position limits would have if implemented at the very high levels suggested in the Re-Proposed Rule. Under the Re-proposal, spot-month positions limits would be set at 25 percent of the estimated deliverable supply. Additionally, under the Re-proposal, non-spot month positions would be set at 10 percent of the open interest for the first 25,000 contracts and 2.5 percent of the open interest thereafter.[13] These are effectively the same inflated limits that have been in place for legacy commodity contracts for years, ever since the long-standing previous position limits regime was gradually eroded in the 1990s and 2000s.[14]

Yet within the past few years, numerous violations of even these bloated limits have been documented demonstrating a need for more stringent limits. Large investment banks

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12 In similar instances, the Commission has at least presented aggregated data and findings for public comment. For instance, in the Swap Entity Definition Rule, data was presented to give commenters a sense of how many entities would be affected by setting the various classification criteria at different levels. A similar analysis in the case of position limits would be of great benefit, and is well within the Commission's capabilities to produce.

13 Fed Reg. at 96760.

14 Fed Reg. at 96765.

like Citi[15] and JP Morgan;[16] foreign banks like ANZ[17] and UBS;[18] commodities operations such as Merrill Lynch Commodities;[19] Futures Commission Merchants like Newedge;[20] proprietary trading firms like Sheenson Investments;[21] and even individuals like James Masterson[22] have all been fined for violating position limits in commodity markets since the passage of Dodd-Frank required the CFTC to clamp down on excessive speculation. In a single week, over $2 million in fines were assessed for traders exceeding position limits in cotton alone.[23]

What this demonstrates is that there are at any given time a large number of speculators operating close to the position limit threshold. To eliminate this damaging pattern, it is essential that limits be lowered and set at a level aimed at maintaining no more than 30 percent speculation in each commodity, and tightened or loosened on a 6-month basis depending on the actual level of speculation observed in the market. Basing position limits on an arbitrary percentage of open interest like 10 percent--as in the Proposal--is counter to Congressional intent, and is subject to a perverse feedback loop where increased speculative open interest begets higher limits on speculation. The Commission must therefore take the more direct approach and derive individual limits from the overall proportion of open interest permitted to speculators.

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15 *See* Alper, Alexandra, Citi to pay penalty for position limits violation: CFTC" (Sep. 21, 2012), *available at* http://www.reuters.com/article/2012/09/21/us-cftc-citigroup-idUSBRE88K16320120921.

16 *See* CFTC Press Release "CFTC Orders JP Morgan Chase Bank, N.A. to Pay $600,000 Civil Monetary Penalty for Violating Cotton Futures Speculative Position Limits" (Sept. 27, 2012), *available at* http://www.cftc.gov/PressRoom/PressReleases/pr6369-12.

17 *See* "ANZ cops US fine for 'excessive speculation'" (Sept. 28, 2012), *available at* http://www.smh.com.au/business/banking-and-finance/anz-cops-us-fine-for-excessive-speculation-20120928-26pdo.html.

18 *See* Weinberger, Evan, "CFTC Fines UBS Over Position Limits On Energy Futures" (Feb. 25, 2010), *available at* http://www.law360.com/articles/151764/cftc-fines-ubs-over-position-limits-on-energy-futures.

19 *See* Warner, Melodie, "CFTC Fines Merrill Lynch Commodities $350,000 For Exceeding Position Limits" (Dec. 7, 2011), *available at* http://online.wsj.com/article/BT-CO-20111207-710223.html.

20 *See* Press Release "CFTC fines Newedge for exceeding position limits" (Feb. 7, 2011), *available at* http://www.futuresmag.com/2011/02/07/cftc-fines-newedge-for-exceeding-position-limits.

21 *See* "ANZ cops US fine for 'excessive speculation'" (Sept. 28, 2012), *available at* http://www.smh.com.au/business/banking-and-finance/anz-cops-us-fine-for-excessive-speculation-20120928-26pdo.html.

22 *See* Wilson, Jeff, "CME Fines Speculator $15,000 for Violating Position Limit Rules" (Feb. 4, 2011), *available at* http://www.bloomberg.com/news/2011-02-04/cme-fines-speculator-15-000-for-violating-position-limit-rules.html.

23 *See* Perez, Marvin, "U.S. Regulators Fines on Cotton Trading Limits Tops $2 Million" (Sept. 28, 2012), *available at* http://www.businessweek.com/news/2012-09-28/u-dot-s-dot-regulators-fines-on-cotton-trading-limits-tops-2-million.

4. Conditional Spot Limits Must Be Removed.

Under the Re-Proposal, traders may acquire positions for natural gas up to 10,000 contracts if such positions are exclusively in cash-settled contracts.[24] However, there is no justification for treating cash and physically-settled contracts differently in any month, and settlement characteristics should not be a determinant of the ability to exceed the limits in any month. [25] The rationale behind including conditional spot limits, which allow a trader with only cash-settled contracts to hold up to 10,000 contracts,[26] is yet another instance of the Commission inappropriately crafting rules that target manipulation instead of the broader category of excessive speculation.

Cash-settled contracts can disrupt the price discovery function provided by the futures market. Traders dealing in exclusively cash-settled contracts wield enormous influence on physical prices, both by shaping market expectations of future supply and demand, and directly determining physical transaction prices through contractual convention. Therefore, Conditional Spot Limits represent a departure from the statutory mandate to deter excessive speculation and unjustly allow outsized position concentration in certain contract-types over others. Conditional Spot Limits must be removed, and all settlement-types should be treated equally in relation to the Position Limits that govern them.

5. Only the CFTC Should Have the Authority To Grant Bona Fide Hedge Exemptions.

The Re-Proposal gives the exchanges the authority to grant NEBFHs, ABFHs and spread exemptions, and it expands the bona fide hedge definition. These measures will actually undermine the effort to diminish, eliminate, or prevent excessive speculation, which is the first priority for the CFTC under the Dodd-Frank Act; to reduce the threat of market manipulation, squeezes, and corners; and to ensure price discovery. Specifically, the Commission has taken great lengths to describe, set, and justify a delegation of its authority and a process for exchanges to grant exemptions that exclusively aims to enhance liquidity, while failing to address the probable adverse outcomes of decreased market integrity would result in excessive speculation, market manipulation, counterproductive increased volume instead of liquidity, or impaired price discovery.

Only the Commission, and not the exchanges, should have this exemptive authority with respect to hedging activity. Only the Commission has the ability to appropriately and comprehensively monitor the participants in these markets to ensure that non-commercial participants, acting individually or collectively, do not cause **excessive speculation**,

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[24] Fed Reg. at 96778.

[25] Proposed Rule § 150.3(c) (c) Conditional spot-month limit exemption. The position limits set forth in § 150.2 may be exceeded for cash- settled referenced contracts provided that such positions do not exceed five times the level of the spot-month limit specified by the Commission and the person holding or controlling such positions does not hold or control positions in spot-month physical-delivery referenced contracts.

[26] Fed Reg. at 96778.

damaging the utility of the commodity markets for those who need them. The Commission has access to all of the commodity markets, in sharp contrast to the exchanges that only have access to relatively small parts of the markets. As a result, a Commission-administered process is the only one that will cover the entire marketplace and provide broad and uniform regulation.

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

From a practical implementation standpoint, requiring the exchanges to recognize NEBFH's, with the Commission serving merely as the second line of review, would be inappropriate for multiple reasons. First, market participants would likely migrate to the exchanges that tend to be more lenient in recognizing NEBFHs, which would cause a race to the bottom for exemption recognition while simultaneously reducing market integrity. Second, as stated above, the exchanges do not have a complete picture of the markets, so they cannot properly see the impact of a hedge on the commodity markets in totality.

For all these reasons, only the Commission, rather than the exchanges, is capable of adequately serving the four key Dodd-Frank Act objectives enumerated above as it exercises exemptive authority.

6. Bona Fide Hedges Should Be Linked to Demonstrable Physical Positions.

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

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

Any amendment to the bona fide hedge determination process must include an effort to remediate an enormous flaw in the Re-Proposed Rule, which effectively allows financial hedges for commodity index funds to avail themselves of bona fide hedge exemptions. The financial risk management activities of swap dealers should not be considered bona fide hedges, and the requirement that such hedges be substantiated by activity in the physical market (not by offsetting positions in swaps) would work to remedy this troubling loophole.[27]

Indeed, the fundamental objective of position limits is to restrain speculative activity that is unrelated to hedging of physical commodities. Swap dealers, financial derivative offsets, and purely speculative market participants should be universally subject to strict, comprehensive limits.

While there is merit to the concerns of legitimate end-users, who are frustrated with the prospect of retrofitting their activities, it is important to remember that there are rules are in place precisely to protect their interests.[28] The overwhelming influence of unbridled excessive speculation have hijacked these important markets, most notably in 2008, and will likely do so again without proper regulation and then oversight.

7. Limits Must Be Reset More Frequently Than Every Two Years.

According to the Re-Proposal, the spot month, non-spot month, and all-months-combined position limits will be updated no less frequently than every two calendar years. Biennial updates to limits are completely inadequate, and the frequency must be reconsidered.[29] In fact, the clear trend of market measurement across market data providers is higher-frequency temporal data. Thus, in this case it seems the CFTC is going in precisely the wrong direction.

Moreover, the CFTC is in the midst of a major overhaul of its data regime, and the capacity to record, analyze, and quickly react to market data has never been greater and continues to expand. The vast data collected from Derivatives Clearing Organizations, Swap Data Repositories, and exchanges will for the first time allow the Commission to make adjustments to regulatory measures almost on demand. There is no justification for not taking full regulatory advantage of new data resources that can enable more timely and market-appropriate limits.

Finally, when the Part 151 Position Limits rules were proposed in 2011, the proposed compliance frequency was yearly. This low frequency was criticized by end-user groups and hedgers for being far too infrequent to adequately account for market changes. The Interim Final rule, however, valued the input of swap dealers and their trade groups over that of commercial hedgers and followed the industry recommendation to further reduce the frequency from yearly to every two years. The Re-Proposal adheres to this de-regulatory approach.

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

28 Section 2(h)(7).

29 Section 150.2(e)(3).

Unfortunately, as market conditions change, and position limits set earlier become outdated, they can easily become a "safe harbor" for trading activity. Thus, updating position limits more frequently will also confer significant benefits on the marketplace. Position limit changes will more accurately reflect current market conditions and more precisely serve the regulatory purposes underlying the position limits rules.

The rules should be designed in such a way that they encourage market participants to monitor their own open interest in order to maintain compliance. Regular updates of position limits will motivate traders to implement stringent monitoring and corrective procedures to adjust their activities to remain in compliance.

8. <u>There Should Be No Delay in Implementing Position Limits for Swaps.</u>

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

> "(1) It had access to daily information about its market participants' open swap positions; or
>
> (2) it knows that its market participants regularly engage on its exchange in large volumes of speculative trading activity (it may gain that knowledge through surveillance of heavy trading activity), that would cause reasonable surveillance personnel at an exchange to inquire further about a market participant's intentions and total open swap positions."[30]

Much has been made of the fact that data on swaps and swaptions will not be fully available for some time for the exchanges, and it has been argued from some quarters that this is a reason to delay implementing position limits. In reality, though, this state of affairs simply highlights the need to vest authority to set and implement position limits exclusively in the Commission, not the exchanges. The Commission already has access to the data necessary to implement swaps position limits, and these important regulatory tools should not be subject to the vagaries of the exchanges' different levels of data access.

Additionally, there should be no doubt that regulation of excessive speculation in the swaps market must mirror the futures markets rules. Swaps markets generally reference futures markets for pricing. Moreover, activity in swaps affects prices. Position limits for swaps, aimed at curbing excessive speculation in the swaps markets, will reduce costs for bona-fide hedgers. It is therefore important that position limits be applied as soon as possible in the swaps markets.

[30] Fed Reg. at 38460-38461.

CONCLUSION

There is simply no valid reason for the Commission to weaken its 2013 Position Limits Proposal. It has a clear statutory mandate in Dodd Frank and the CEA to end excessive speculation. The integrity of the markets and the fortunes of America's producers and purchasers—and ultimately the American public—depend on these markets and the Commission's ability to effectively police them. Thus, the Commission must overhaul the Proposal as detailed above, to fully implement the law.

We hope these comments are helpful.

Sincerely,

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