



September 30, 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: CFTC Requests Public Input on Simplifying Rules (“Project KISS”) – Miscellaneous

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 through the “Keep It Simple Stupid” or KISS Initiative. Position limits and affiliated matters (i.e. aggregation and bona fide hedging) can have a profound impact on the commodities industry generally and agricultural commodities like North American Hard Red Spring Wheat (“HRSW”) in particular. MGEX has previously submitted comments on 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, November 8, 2016 and February 28, 2017.

MGEX is both a Subpart C Derivatives Clearing Organization (“DCO”) and a Designated Contract Market (“DCM”), and has been the primary marketplace for 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”)¹.

Position limits is one area where there is a large, pending proposed rulemaking that MGEX has commented repeatedly. Overall, it is vitally important that the cost of regulation not outweigh the benefit of the regulation. 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. This increase in regulation as well as 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/DCMs remaining, MGEX

¹ H.R. 4173, Pub. L. No. 111-203, 124 Stat. 1376 (July 21, 2010).

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 or FCM space. Due to the high and increasing cost of regulation and the pending nature of position limits, MGEX supports the KISS initiative to simplify, modernize, and reduce costs and is an appropriate avenue for MGEX to comment.

Position Limits – One Size Does Not Fit All

MGEX requests that the Commission, when determining whether to establish position limits evaluate: the reason limits are needed, the history of a given contract, a contract's position in the overall market, the commercial realities in play and other relevant factors. The CFTC, through its various proposals on position limits has taken a number of different formulaic approaches. While these formulas may appear convenient they do not take into account the realities of the market. Moreover, 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.

Wheat Parity

Specifically, one area where the formulaic approach needs to be tossed aside or at least reconsidered is in the wheat contracts. 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. Wheat parity has worked well and predates Dodd-Frank and the latest changes (and proposed changes) to the position limits framework. This is an area where if it is not broken, the Commission does not need to 'fix it', in other words 'keep it simple stupid'.

The Future of Setting Limits

In the event the Commission finds a formulaic approach to be necessary the method for determining position limits should not be limited to open interest. Important data, such as crop production should be considered as production better reflects the underlying physical product and associated risks of physically delivered agricultural products. Therefore, alternative methods to establish limits should be permitted.

Bona Fide Hedging

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, should be broad enough to align with and include commercial hedging practices. There has been no demonstrated need to limit the scope of bona fide hedging and certainly no adequate cause to make it so complicated.

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.

Exemptions to Position Limits

One example where MGEX requests the Commission reevaluate its regulatory structure is the exemption process outlined in the latest Reproposal² of position limits. This is illustrative of the Commission complicating a procedure unnecessarily and with high compliance costs.

Multiple Exemption Processes

Specifically, 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.

If the Commission chooses to continue down the complicated path to unnecessarily restrict the definition of bona fide hedging, MGEX requests at a minimum 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).

² See *Position Limits for Derivatives, Reproposal*, 81 Fed. Reg. 96, 704 (Dec. 30, 2016).

CFTC Second Guessing

It is 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]”³ 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 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.”⁴

This process permits 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 or are likely to cause market disruption or market manipulation. Furthermore, an order to unwind positions should not occur if it would lead to potential market disruption.

The quartet of processes for determining a bona fide hedge along with unpredictable Commission review is the opposite of simple, modern, and cost effective. Having parallel structures for requesting bona fide hedge exemptions is unnecessary and burdensome. Commodities is a self-regulated industry and the Commission should defer to the exchanges who are much more familiar with each individual contract. MGEX has 134 years of experience with its HRSW contract and has a vested interest its success, stability, and reliability. Moreover, as proposed duplication, overlap, confusion, and corresponding higher costs are inevitable. And, even if all of the processes for granting

³ 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).

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

an exemption are followed the CFTC can yank everything back by second-guessing the exchange's determination and require liquidation. In addition to being cumbersome, this process fails to be predictable or reliable harming the commercial end users who rely on bona fide hedging to manage their risk.

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, looped "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