



## Via Electronic Submission

May 13, 2020

Christopher Kirkpatrick  
Secretary of the Commission  
Commodity Futures Trading Commission  
1155 21st Street, N.W.  
Washington, DC 20581

### **Re: Notice of Proposed Rulemaking on Position Limits for Derivatives—RIN 3038–AD99**

Dear Mr. Kirkpatrick,

CHS Inc. (“*CHS Inc.*”) and CHS Hedging, LLC (“*CHS Hedging*”) appreciate the opportunity to provide the Commodity Futures Trading Commission (“*Commission*”) with comments and recommendations in response to the Commission’s proposed rulemaking on position limits for derivatives.<sup>1</sup> At times, CHS Inc. and CHS Hedging are collectively referred to as “*CHS*.”

CHS Inc. is the nation’s leading integrated agricultural cooperative, providing grain, foods and energy resources to businesses and consumers on a global basis. As a cooperative, CHS Inc. is owned by farmers and ranchers and their member cooperatives across the United States. CHS Inc. buys commodities from and provides products and services to agricultural producers, local cooperatives and other companies, both domestically and internationally. CHS Inc. provides a wide variety of products and services, ranging from agricultural inputs such as fuels, farm supplies, crop nutrients and crop protection products, to agricultural outputs that include grains and oilseeds, grain and oilseed processing, renewable fuels and food products. First organized in 1929, CHS Inc. employs more than 11,000 people around the globe who provide CHS Inc.’s owners with a strong, efficient supply chain, global market access and inputs.

CHS Hedging is a futures commission merchant (“*FCM*”) that provides full-service commodity price risk management and market intelligence to its customers, primarily through the use of exchange-traded futures and options but also through the use of uncleared, OTC products. CHS Hedging is focused on the agriculture and energy sectors, which compliments the businesses of its sole parent, CHS Inc. The customer base of CHS Hedging consists primarily of commercial agriculture and energy businesses, such as grain elevators and energy supply companies, and individual and corporate farmers and ranchers.

The Commission’s proposal is critically important to CHS given CHS Inc.’s role as a significant market participant in the markets subject to position limits and CHS Hedging’s role as an FCM to grain

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<sup>1</sup> See *Position Limits for Derivatives*, 85 Fed. Reg. 11596 (Feb. 27, 2020).

and energy customers.

CHS commends the Commission and the Commission staff for making important modifications to its prior position limits proposals, most recently in 2016.<sup>2</sup> While CHS generally supports the Commission's proposed rulemaking, CHS highlights below several items that are critically important not only to CHS, but CHS believes, to similarly situated market participants as well.

**1. CHS believes that the Commission's proposed rules represent positive progress in addressing position limits.**

In issuing its proposal, CHS welcomes the Commission's goal of providing "broader discretion for market participants to measure risk in the manner most suitable for their business."<sup>3</sup> In this regard, CHS believes that position limits must seek to "ensure sufficient market liquidity for *bona fide* hedgers" and provide for exemptions to position limits for *bona fide* hedging transactions so as "to permit producers, purchasers, sellers, middlemen, and users of a commodity or a product derived therefrom to hedge their legitimate anticipated business needs for that period of time into the future for which an appropriate futures contract is open and available on an exchange."<sup>4</sup>

Prior to addressing specific aspects of the proposal that CHS believes should be reconsidered or modified, CHS acknowledges the material changes that the Commission has made to the proposed rules in response to discussions with and comments submitted by market participants. These changes significantly improve upon prior versions of the proposed rules. In particular, CHS supports:

- the general definition of a *bona fide* hedge;
- the expansion and updating of the enumerated hedges;
- the exclusion of location basis contracts, swap guarantees and trade options from speculative position limits;
- the decision not to impose position limits outside of the spot month for the energy, metals and certain agricultural core referenced contracts (and related referenced contracts);
- the ability for market participants to apply to an exchange for an exemption from federal limits and the process for seeking such relief;
- providing market participants with the flexibility to decide whether to hedge on a gross or net basis; and
- the elimination of Form 204.

**2. CHS strongly supports the expansion of the enumerated *bona fide* hedge exemption categories, but requests certain clarifications.**

As the Commission knows, the general definition of a *bona fide* hedge requires that a hedge: (a) represent a substitute for transactions made or to be made, or positions taken or to be taken, at a later time in a physical marketing channel ("Temporary Substitute Test"); (b) be economically appropriate to the reduction of price risks in the conduct and management of a commercial enterprise ("Economically Appropriate Test"); and (c) arise from the potential change in value of (i) assets which a person owns,

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<sup>2</sup> See *Position Limits for Derivatives*, 81 Fed. Reg. 96704 (Dec. 30, 2016).

<sup>3</sup> 81 Fed. Reg. 11598.

<sup>4</sup> See CEA § 4a(c)(1)–(2), 7 USC § 6a(c)(1)–(2) (emphasis added).

produces, manufactures, processes or merchandises or anticipates owning, producing, manufacturing, processing or merchandising; (ii) liabilities that a person owes or anticipates incurring; or (iii) services that a person provides or purchases, or anticipates providing or purchasing.

CHS supports the general definition of *bona fide* hedge for contracts subject to federal limits, but urges the Commission to retain discretion to recognize *bona fide* hedges that reduce risks other than *price* risk, such as those relating to transportation, supply, weather and macro-related events, such as elections, strikes, embargoes, pandemics, etc. CHS views such an expansion as critically important to market participants, and particularly commercial end-users.

Further, CHS strongly supports the Commission's proposed expansion of enumerated hedges. CHS believes that the new and updated hedge exemptions are responsive to market dynamics and the needs of many market participants. That being said, CHS believes that the proposal misses a few opportunities to enumerate important types of hedges, which are discussed below. CHS asks the Commission to designate each of the below hedges as an enumerated hedge.

#### *Example 1: Unfixed Price Hedge*

Assume that a merchandiser sells a vessel of soybeans to a counterparty out of the Gulf for May shipment (*i.e.* a basis contract over May soybean futures). The counterparty has not priced the futures price component (perhaps because the customer does not want to buy futures yet or the merchandiser would prefer that the customer not exchange futures for physical as it may put more risk on the merchandiser for default risk.) In any event, the merchandiser evaluates logistical considerations, including buying soybeans to send to the Gulf, in order to have the soybeans in the port and to load them onto the vessel in May. Further assume that the merchandiser is either not able to buy soybeans or the most economical way to procure them is through delivery. The merchandiser thus goes long March soybeans.

It appears to CHS that such a scenario, while ostensibly constituting a *bona fide* hedge, does not clearly fall within any of the current or proposed enumerated hedges. Given the nature of the hedge, however, CHS respectfully requests that the Commission include the Unfixed Price Hedge as an enumerated hedge. Such inclusion will provide much needed clarity for market participants.

#### *Example 2: Grain Export Hedge*

In the context of an anticipatory merchandising hedge, assume that a merchandiser in March enters into a contract to sell vessels of a grain to a counterparty in Europe or Asia, with delivery in September. The contract is priced at \$0.65 over the applicable September futures contract. The merchandiser will need to purchase the grain and transport it to the export elevator in time for the load-out. Assume further that the counterparty has the option to fix the price by transferring September futures to the merchandiser via an exchange for physical prior to delivery. The September futures contract will not provide supply protection for the merchandiser's commitment to the counterparty because the futures delivery for September grain would not be in time to satisfy the merchandiser's contractual commitment. The merchandiser thus needs time protection to cover its sale.

Where, for example, delivery is called for in September, but the July futures contract—not the September futures contract—is the optimal hedge for the merchandiser, the merchandiser would want to

enter into a calendar spread transaction to hedge its risk (and thus hedge its physical supply commitment to the counterparty). As CHS understands the proposal, however, such an anticipatory hedge would not constitute an enumerated hedge, which could result in a less economically efficient export transaction. While, from CHS's perspective, such a position is *bona fide*, CHS urges the Commission to recognize the Grain Export Hedge as an enumerated hedge.

### *Example 3: Winter Storage Hedge*

Finally, assume that a supplier leases storage in the winter season to store and provide gas and diesel during the following summer season. The supplier of the leased storage might be able to hedge its exposure and lock in a profit associated with that storage by using the futures markets. For example, if the supplier has purchased or intends to purchase gas in December and to then sell gas out of storage in July, the supplier can effectively enter into that transaction in the futures markets by buying December gas futures and selling July gas futures, thus locking in the differential. However, neither the December nor the July futures contracts would appear to qualify for *bona fide* hedge treatment under the proposed rule. This type of storage transaction should be viewed as *bona fide* hedging treatment because it functions as a substitute for transactions to be made at a later time in a physical marketing channel, which is economically appropriate to the reduction of the supplier's risk. CHS urges the Commission to enumerate such a hedge as a *bona fide* hedge.

### **3. CHS believes that the inclusion of swaps would likely pose an undue burden on active market participants.**

#### **A. Impact on commercial end-users and Commodity-Focused FCMs.**

There is little doubt, from CHS's perspective, that including economically equivalent swaps as "referenced contracts" for position limit purposes will result in a material burden for (a) commercial end-users and (b) small to mid-sized FCMs that focus on the needs of grain and energy hedgers, which are referred to as "*Commodity-Focused FCMs*". The costs of compliance on such participants will likely be large and time-consuming, and possibly entail some risk of operational error arising out of the implementation process.

With respect to commercial end-users, absent additional Commission guidance CHS believes that the burdens will take the form of (a) determining which types of swaps will be deemed to be economically equivalent swaps, (b) making significant and costly modifications to systems to identify and track transactions for reporting purposes, (c) developing tools for swaps aggregation purposes (or manually conducting such tasks if such a tool is not readily available to be interpolated into existing systems) and (d) determining intraday positions when addressing economically equivalent swaps, which will require real-time system reporting and real-time exception alerts, among other things.

Further, as CHS believes the Commission is aware, the past several years have seen an increasing consolidation of FCMs, leaving fewer and fewer FCMs in the marketplace, which has resulted in reduced options for commodity interest customers. Today, there remain relatively few Commodity-Focused FCMs, such as CHS Hedging, and CHS urges the Commission to be particularly sensitive to the implications of the proposal on such entities. By including economically equivalent swaps as referenced contracts, the burdens to Commodity-Focused FCMs would include each of the burdens described in the preceding paragraph. Moreover, as many FCMs have operated on thin margins

during the protracted low interest rate environment, FCMs—and particularly Commodity-Focused FCMs—need relief from regulatory burdens, not increases. CHS thus reiterates its desire that the Commission be keenly mindful of the impact of its proposed rulemaking on Commodity-Focused FCMs.

In these respects, CHS asks the Commission to be mindful and more fully address the costs and benefits applicable to commercial end-users and Commodity-Focused FCMs, and to provide more clarity regarding the scope of referenced contracts. As a guide, CHS urges the Commission to maintain as narrow a definition of “referenced contract” as possible. CHS also urges the Commission, both in the context of market participants generally and commercial end-users and Commodity-Focused FCMs particularly, to address CHS’s recommendations in the following section.

**B. To the extent that swaps are part of the position limit regime, the Commission should establish a transition period and adopt a “safe harbor” under which demonstrable *good faith* compliance with respect to *inadvertent* violations would not serve as the basis for an enforcement action.**

If the Commission includes swaps as a referenced contract, CHS recommends that the Commission take two separate steps. First, the Commission should provide all market participants with a transition period of at least one year to comply with any final speculative position limits. Given the complexity associated with the application of position limits to swaps, a transition period of at least one year would help CHS and other market participants develop, test and implement the information technology, reporting, supervisory and compliance systems necessary to comply with the new position limit requirements. CHS believes that such a transition is particularly important for commercial end-users and Commodity-Focused FCMs.

As important, CHS urges the Commission not to pursue a strict liability approach with respect to all types of errors resulting in rule violations that arise out of the new requirements, but rather adopt a safe harbor to address, in limited fashion, certain types of errors. Specifically, CHS believes that a safe harbor from enforcement should apply to any position limit violation involving the new requirements that arises out of: (a) a demonstrably inadvertent operational or systems-related error; (b) where there is demonstrable good faith compliance with respect to the new requirements; and (c) where such error resulting in a rule violation is timely self-reported to Commission staff following discovery.

Such a safe harbor would promote several important objectives, including the implementation and maintenance of robust compliance in order to fall within the safe harbor, the elimination of strict liability for mistakes for which there is no evidence of wrongdoing and the self-reporting of violations to appropriate Commission staff.

CHS is aware that the Commission, in 2012, under then-Chairman Gary Gensler, considered a similar type of safe harbor with respect to the establishment of the swap reporting regime. In connection with the proposal of those requirements, several trade associations recommended that the Commission adopt a safe harbor to address good faith mistakes made by a counterparty in reporting swap data and for errors of which the counterparties were not aware.<sup>5</sup> Indeed, one of the trade associations asked the Commission to state explicitly that it would not sanction parties for inadvertent errors in reporting, and

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<sup>5</sup> See, e.g., *Swap Data Recordkeeping and Reporting Requirements*, 77 Fed. Reg. 2136, 2170 (Jan. 13, 2012).

that good faith efforts to comply with new requirements would not result in exposure to enforcement actions. While the Commission considered, but ultimately did not take such action at that time, CHS believes that a more fitting opportunity exists with respect to the application of position limits to swaps, particularly considering the impact of any final rulemaking on commercial end-users and Commodity-Focused FCMs.

**4. CHS strongly supports the elimination of Form 204 and urges the Commission not to tie such action to the adoption of amendments to the position limit regime.**

CHS applauds the Commission's proposal to eliminate the Form 204 filing requirement and to leverage the cash-market information reported to the exchanges. CHS believes that the Commission should move forward with such elimination *notwithstanding* any action that the Commission may or may not take with respect to position limits. In other words, CHS urges the Commission not to tie the Form 204 elimination to position limit approval. As noted by the Commission, the exchanges already have or are in the position to obtain the requisite cash-market information.

**5. While CHS generally supports deference to the exchanges with respect to hedge exemptions and related matters, the Commission should ensure that such deference does not come with a cost in the form of materially increased exchange fees.**

As noted, CHS generally supports the Commission's approach of deferring to the exchanges in respect of various items of the proposal. The question CHS has, however, is at what cost? To the extent that the exchanges assume responsibilities previously discharged by the Commission and take on new responsibilities under the proposal, the Commission should consider and discuss the potential financial impact of such a delegation on market participants, particularly on Commodity-Focused FCMs. CHS assumes that exchanges, as for-profit entities, will not assume such obligations without passing along the costs to its customers. What then, is the cost? CHS asks the Commission to address this important component of the proposal.

**6. The Commission should address the cross-border application of the rules.**

CHS believes that global organizations should be in a position to better understand the Commission's approach with respect to the cross-border application of the rules to referenced contract positions. In CHS's view, the proposal does not address whether and how global companies must aggregate referenced contract positions of affiliates around the world. As part of the retooling of the position limit regime, CHS urges the Commission to address such an application.

**7. Conclusion**

While CHS generally supports many aspects of the Commission's proposal, CHS urges the Commission to consider the comments raised herein. CHS believes that these comments are relevant not only to CHS, but to many other similarly situated market participants. CHS thanks the Commission and the Commission staff for their efforts on the proposal and looks forward to receiving feedback.

Please contact Jack Lenzi, CHS Inc.'s Chief Compliance Officer, at (651) 355-4957 or at john.lenzi@chsinc.com if you have any questions about CHS' comments or recommendations.

Respectfully submitted,

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