ISDA® Safe, Efficient Markets

May 15, 2020

Submitted Electronically

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

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

Dear Mr. Kirkpatrick:

The International Swaps and Derivatives Association, Inc. ("ISDA")[1] appreciates the opportunity to submit these comments with respect to the notice of proposed rulemaking published by the Commodity Futures Trading Commission (the "CFTC" or the "Commission") regarding rules governing position limits on derivatives on physical commodities (the "Proposal").[2] In order to facilitate the Commission's review of these comments, ISDA intends to submit an appendix to this letter specifically enumerating the recommended revisions. ISDA commends the tremendous amount of effort and work that has been put into the Proposal by the Commission and staff, all of which is reflected in the Proposal. Subject to the comments below, ISDA looks forward to supporting the Commission's efforts in finalizing these rules.

Introduction

As the trade association for the global derivatives market, ISDA monitors regulatory developments that could affect the ability of market participants to use derivatives to, among other things, execute hedging and risk management strategies. ISDA, either on its own or jointly with fellow trade associations, has previously submitted a series of

[1] Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has more than 900 member institutions from 73 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org.

[2] *See* Position Limits for Derivatives, 85 Fed. Reg. 11,596 (Feb. 27. 2020), https://www.cftc.gov/sites/default/files/2020/02/2020-02320a.pdf.

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comment letters addressing the CFTC's various proposed position limits rules,[3] and ISDA appreciates the efforts that the Commission and staff have made to incorporate many of these comments into the current Proposal.

As the CFTC reviews the comments on the current Proposal and prepares to construct its final rules, ISDA and its members continue to encourage the CFTC to produce a final ruleset that is practical in scope and structure, and not unnecessarily complex. Similarly, ISDA encourages the Commission to consider finalizing the Proposal in phases, based on product scope and starting first with physically delivered spot month futures contracts. ISDA believes that an incremental and phased approach to final position limits rules will allow the CFTC to achieve meaningful progress on this effort, while minimizing the risk of disruptions to markets and major increases in compliance costs for market participants. In connection with a phased approach to final rulemakings, ISDA also requests that the CFTC include an implementation timeline that recognizes both the compliance burdens associated with a major new ruleset as well as the staffing and resource prioritization issues that firms are navigating in this time of economic uncertainty. With these perspectives in mind, ISDA submits the following comments on the CFTC's Proposal, and we stand ready to provide any additional material or information that may be helpful to the CFTC and staff in considering these comments.

Executive Summary of Comments

- *ISDA supports the CFTC's determination to develop robust and empirically supported necessity and appropriateness findings in connection with any final position limits rulemakings and the specific position limits adopted —now and in the future.*
- *The CFTC should finalize the proposed Federal position limits rules only for physically delivered spot month futures contracts, in the first phase.*
- *Whether or not the CFTC determines to go forward with Federal limits on financially settled futures and/or economically equivalent swaps, ISDA is generally supportive of the proposed definition of economically equivalent swap, subject to the comments herein.*
- *The CFTC and the exchanges must continue to recognize and grant risk management exemptions from position limits.*
- *In order to avoid unnecessary disruption, each final rule that is adopted should be phased-in over at least 12 months and should include clear exemptions for all pre-existing positions.*

We have also included comments and requests for clarification on various other aspects of the Proposal.

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[3] For the most recent letter, *see* ISDA Comment Letter re: Position Limits for Derivatives: Re-Proposal (RIN 3038-AD99), (Feb. 23, 2017), https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=61096.

Comments on the Proposal

ISDA supports the CFTC's determination to develop robust and empirically supported necessity and appropriateness findings in any final position limits rulemakings and the specific position limits adopted —now and in the future.

The Commodity Exchange Act (the "CEA") provides that the CFTC may adopt position limits "as the Commission finds are necessary to diminish, eliminate, or prevent [the] burden" of excessive speculation "as appropriate."[4] ISDA agrees with the CFTC's view that when Congress used the words of "necessary" and "appropriate" in connection with the position limits provisions of the CEA, those words represented intentional and meaningful boundaries on the scope of the CFTC's position limits rulemaking authority. ISDA similarly appreciates the effort that the Commission has made in including its tentative necessity finding in the Proposal, and ISDA encourages the CFTC to continue to make clear, in any final rule, that any exercise of its position limits rulemaking authority must be supported by robust and data-driven necessity and appropriateness findings.

Importantly, and in the context of the current Proposal, ISDA believes that the statute requires that this necessity determination also be made in connection with any specific position limits that are adopted. ISDA therefore respectfully requests that the CFTC expressly clarify that it has not yet made a necessity finding that would support imposing federal position limits outside of the spot month, other than for those legacy agricultural futures contracts that are already subject to federal limits. The CFTC's determinations on these points will establish the standard on which position limits rulemakings, and changes to position limits levels, will be made for the foreseeable future, and the standard must continue to be developed in a way that is intentional and deliberate.

The CFTC should finalize the proposed Federal position limits rules only for physically delivered spot month futures contracts, in the first phase.

ISDA understands and supports the CFTC's efforts to move as swiftly as possible in order to finalize a rulemaking. These rules will represent a meaningful and substantial accomplishment by the CFTC of the Congressional authority provided in the Dodd-Frank Act to adopt a federal position limits regime, pursuant to a necessity finding. However, in order to achieve a final rule that is also practical, both in scope and structure, ISDA encourages the CFTC to take a phased approach with respect to the scope of products to be covered by the final rule. Specifically, the CFTC should prioritize those aspects of the Proposal that would create a new Federal position limits regime on the 25 spot month physically delivered futures contracts that have been identified as core referenced futures contracts—and the CFTC should reserve taking any final action with respect to financially settled futures or swaps.[5] The spot month period for physically delivered

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[4] 7 U.S.C. § 6a(a).

[5] However, ISDA does encourage the CFTC to finalize the higher proposed limit levels for any and all month limits for the nine legacy agricultural futures contracts. Market participants and the CFTC already have experience with implementing Federal any- and all-month limits for these products, and the proposed increases in these position limit levels are long overdue. The amended limit levels should be finalized as

commodity futures is the most critical intersection of the derivatives markets with physical commodity prices, and this is one of the principal time periods in which trading related to physical commodity price manipulation, when it has occurred, has occurred. The spot month for physically delivered futures contracts is therefore the logical starting point.

However, market participants and regulators alike recognize that a new Federal position limits rulemaking will involve significant compliance costs and burdens, as well as a range of unknowns in terms of impact on markets, liquidity, volatility, and ultimately, the feasibility of using derivative markets to hedge physical commodity price risk.[6] ISDA strongly believes that the CFTC can mitigate these compliance costs and burdens, and the related uncertainties, by starting with final rules only for physically delivered spot month futures contracts in a first phase. As noted above, the CFTC should reserve making any determinations on, or adopting final rules applicable to, financially settled futures or any swaps in this first phase. After the initial set of limits has been finalized and implemented, and after taking into account any "lessons learned," the CFTC could then revisit the remaining aspects of the current Proposal in order to identify which, if any, additional product sets present a real and demonstrated need for position limits and additional rules. We believe that this approach will better serve the Commission's interests and objectives by allowing it to take into account the experience with spot month limits and craft a position limits regime in other respects that is more closely calibrated to the CFTC's oversight needs and the efficient operation of the markets.

Indeed, in ISDA's view, this approach is consistent with, and actually mandated by, the CFTC's statutory authority to adopt limits, be they for futures, swaps, or any other product subject to CFTC jurisdiction, only "as the Commission finds are necessary to diminish, eliminate, or prevent [the] burden" of "[e]xcessive speculation[,] . . . as appropriate." This language clearly applies to any position limits adopted by the Commission, and cannot be interpreted to apply only to limits on futures. With respect to the timing of the implementation of position limits on other products, while ISDA agrees that CEA section 4a(a)(5) directs the CFTC to establish limits for economically equivalent swaps "simultaneously" with the limits the CFTC determines to impose on futures, that reading of section 4a(a)(5) is incomplete and does not reflect the full context and intent of the provision. In particular, the swaps provisions in section 4a(a)(5) include the same "as appropriate" qualifying language that the CFTC already interprets to qualify its authority to adopt limits for futures. Accordingly, this identical phrase – used in the same section of the statute, should have the same meaning when used in the swaps provision. The qualifications in the statute make it clear that the CFTC is required to make findings with respect to the need for such limits and to adopt limits that are calibrated to that need and that take into account the potential costs and disruptions to market participants. Therefore, ISDA encourages the Commission, if it moves forward

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soon as is possible in order to accommodate the growth that has occurred in these markets since limit levels were last calibrated.

[6] In fact, the CFTC's Proposal includes an extensive 30-page discussion of the CFTC's own analysis of these considerations. *See* Proposal at 11,671-11,700.

with these limits in a final rule, to continue to include robust necessity findings addressed to each product class that is in scope.

Whether or not the CFTC determines to go forward with Federal limits on financially settled futures and/or economically equivalent swaps, either now or in the future, ISDA supports the proposed definition of economically equivalent swap.

For the reasons set forth in Section II, above, ISDA continues to be of the view that limits for financially settled products – be they swaps or futures – are unnecessary and would impose a level of cost and complexity in implementation that does not correspond to any identified regulatory or policy benefit of such limits. To the extent the CFTC determines to go forward with these limits in this rulemaking, ISDA does support the proposed definition of economically equivalent swap. The definition appropriately recognizes that only swaps that are truly economically equivalent to physically settled futures, including by settlement methodology, would be in scope. Similarly, the definition ensures that financially settled swaps that reference the price of a physically delivered futures contract are out of scope. This definition would be a key component of ensuring that limits on swaps, if they are imposed, do not have an undue impact on liquidity and do not result in market disruptions for a large percentage of the over-the-counter swaps market.[7]

While ISDA offers its support for the proposed definition of economically equivalent swap (certainly as compared to the definitions that have been included in prior CFTC proposals on this subject), the definition would still introduce meaningful compliance burdens and complexity to market participants, which should be taken into account. These involve challenges in identifying and monitoring in-scope products, aggregating those positions with futures positions, in real-time, and assembling the related technology and staffing resources needed to perform these obligations. For these reasons, ISDA re-emphasizes its suggestion to finalize a narrower position limits rule, in the first instance, limited to physically delivered futures contracts.

Similarly, if financially settled futures contracts are included in any final rule, ISDA requests additional clarification on how spot month limits would apply "separately" to physically-settled and cash-settled referenced contracts, and which over-the-counter swaps could be implicated by the inclusion of financially settled futures in the rule. For example, ISDA requests clarification on how the limits would apply to a cash-settled swap that references pricing of a cash-settled future, and whether a swap with a different settlement date structure (*e.g.*, daily versus monthly) would be out-of-scope.

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[7] To the extent the CFTC goes forward with this definition, ISDA encourages the CFTC to expressly acknowledge and confirm that market participants may elect to transact in out-of-scope swaps for any reason, including in order to establish positions that are not subject to CFTC limits—and that this does not amount to a prohibited "willful circumvention of limits." *See* Proposal at 116, 34-35. It is critical that the CFTC not place arbitrary and subjective limits on, or introduce uncertainty into, the ability of market participants to elect to transact in out-of-scope products where such products are otherwise appropriate in the context of their business and objectives.

The CFTC and the exchanges must continue to recognize and grant risk management exemptions from position limits.

It is critical that any position limits rule include a "risk management exemption" for positions taken to manage financial and other risks faced by market participants, and the CFTC should not finalize any proposed statutory interpretation that would prevent the CFTC and the exchanges from continuing to recognize and grant these exemptions. The CFTC and the exchanges have recognized risk management exemptions from position limits for decades, without incident, and the CFTC should affirm that its position limit rules will expressly permit market participants to continue to use the commodity derivatives markets for valid risk management purposes. This would mark a departure from an established and accepted practice—that has been of substantial benefit to end-users—of allowing firms to rely on risk management exemptions. The inability to utilize risk management exemptions will result in increased costs for tailored over-the-counter financial products (many of which are often hedged by dealers in the underlying constituent futures), will cause some dealers to exit the business and will in any event lead to decreases in liquidity in the underlying futures markets, with a corresponding increase in volatility. No material harm has been demonstrated to be caused by risk management exemptions that would warrant these outcomes. More importantly, the risk management exemption facilitates the entry of additional liquidity into markets, including into farther out the curve months, which creates enhanced forward hedging opportunities for commercial firms.[8]

We note that the CFTC's legal analysis in the Proposal would modify the "temporary substitute test"—the test whereby the CFTC has historically, by rule, required that a bona fide hedging transaction or position in a physical commodity must ***normally*** be connected to the production, sale, or use of a physical cash-market commodity. The CFTC argues that when Congress codified this rule-based definition into the CEA, by excluding the word "*normally*" it required that hedges must ***always***—not just normally—represent a physical market substitute. The CFTC proposes that this interpretation will make the risk management exemption unavailable. ISDA strongly urges the CFTC to reconsider this proposed interpretation—particularly the concept that the CFTC should imply the word "always" when Congress did not use that term.

More fundamentally, CEA section 4a(a)(7) provides the CFTC with clear and broad authority to carve out exemptions from position limits,[9] giving the CFTC an independent basis (separate from the bona fide hedging definition) on which to recognize and grant

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[8] Commercial firms typically prefer to hedge as far in advance as is possible, on exchange and cleared, provided that enough liquidity is present in farther out months to keep bid-ask spreads narrow and affordable. Firms relying on the risk management exemption bring this important liquidity and hedging opportunity to futures exchanges, and the CFTC should avoid a final rule that could disrupt or discourage this liquidity.

[9] 7 U.S.C. § 6a(a)(7) ("The Commission, by rule, regulation, or order, may exempt, conditionally or unconditionally, any person or class of persons, any swap or class of swaps, any contract of sale of a commodity for future delivery or class of such contracts, any option or class of options, or any transaction or class of transactions from any requirement it may establish under this section with respect to position limits.").

risk management exemptions. Given the importance of these exemptions to markets and market participants, ISDA strongly encourages the CFTC to ensure that any final rule be accompanied by guidance that clearly empowers both the CFTC and the exchanges to recognize and grant risk management exemptions.

If the CFTC refuses to recognize risk management exemptions, the CFTC should provide a non-disruptive transition period for existing risk management exemptions. Any immediate withdrawal will result in meaningful—and completely unnecessary—disruptions to markets and market participants. ISDA further urges the CFTC to confirm its broad exemptive authority under CEA section 4a(a)(7), and to commit to using this authority as needed when presented with requests for exemptions from market participants.

ISDA appreciates that the higher limit levels set forth in the Proposal, particularly with respect to non-spot month legacy agricultural contracts, could in theory help markets offset any liquidity that may be lost if the risk management exemption is not retained, since higher limits could, among other outcomes, incentivize more firms to participate in markets for these products. However, this is an uncertain result. It presumes that certain dealers or other firms would elect to enter these markets solely as a result of higher Federal position limits—even if that is not consistent with their current business models or objectives. Additionally, these potential new entrants will have to build the customer relationships and operational and market risk management programs required to enter this business, which at a minimum requires transition time and resources. New participants are therefore unlikely to provide meaningful additional liquidity to these markets in the near and medium term.

Furthermore, ISDA understands from its members that the proposed any- and all- month limit levels for the legacy agricultural contracts are not high enough to provide a significant liquidity to these markets based on the experience of market participants and anticipated growth in these markets. Therefore, ISDA requests the non-spot month position limits for the following legacy agricultural contracts adopted in any final rule be no lower than the following:

Contract	Any- and All- Position Limit
CBOT Corn (C)	80,000
CBOT Oats (O)	2,000
CBOT Soybeans (S)	35,500
CBOT Soybean Meal (SM)	20,000
CBOT Soybean Oil (SO)	25,000
CBOT Wheat (W)	35,000
CBOT KC Hard Red Winter Wheat (KW)	35,000
MGEX Hard Red Spring Wheat (MWE)	14,500
ICE Cotton No. 2 (CT)	24,000

In order to avoid unnecessary disruption, each final rule that is adopted should be phased-in over at least 12 months and should include clear exemptions for all pre-existing positions.

ISDA supports including an implementation phase-in of at least 12 months for each final rule that the Commission may issue based on the Proposal. A phase-in period is crucial in order to allow adequate time for market participants to build compliance systems, develop technology, train personnel, and—depending on the scope of the final rule—adjust their businesses. As market participants have learned through the implementation process of multiple major Dodd-Frank rulemakings, there are always unforeseen challenges, costs and market developments that impact the ability of firms to engage in the system builds, compliance trainings and resource allocations needed to comply with new rules. These costs are only magnified by arbitrarily short compliance timelines that create confusion and lead to uncoordinated work streams within firms and at the industry level. This is particularly problematic when no compelling need for immediate implementation of the rules has been identified. Therefore, ISDA supports the proposed 12-month implementation timeline and encourages the Commission to consider additional phasing, for example, by market participant type and size.

Relatedly, it is important that any new position limits rules not be applied on a retroactive basis to pre-existing positions, whether in futures or swaps. The disruptive consequence of requiring one or more market participants to forcibly liquidate previously acquired positions is a significant, and completely avoidable, risk, and ISDA encourages the CFTC to include guidance in each final position limits rule clarifying that all positions acquired prior to the effective date of any final rule will not be subject to any new Federal position limits.

Comments and requests for clarification on various other aspects of the Proposal.

Conditional Limits for Natural Gas Contracts Should Be Revised.

If limits are to apply to financially settled products, ISDA supports including a higher conditional limit for financially settled natural gas products as compared to the limits for the physically delivered contract. However, the higher limits should not be conditioned on prohibiting a market participant from also carrying a position in the physically delivered futures contract. This condition would force important risk taking liquidity out of the physically delivered product at the time when it is needed most by hedgers, and there does not appear to be a market based rationale for this requirement. Instead of forcing risk taking liquidity out of the physically delivered contract, the CFTC should require market participants to comply with the limits for physically settled and financially settled contracts separately, and netting should not be permitted between the two. This would ensure that a larger financially settled position could not be used to exert undue influence on trading in the physically settled product, and would accomplish the Commission's objective, without undue market disruption.

On the same theme of preserving liquidity into the settlement period, positions in financially settled penultimate day expiry contracts in natural gas should continue to be excluded from limits, consistent with longstanding exchange practice. Imposing limits on these products risks disrupting a fragile market structure, and this as well is an unnecessary and avoidable outcome.

Bona Fide Hedging Exemption Should be Practical and Principles Based.

Any position limits final rule should ensure the availability of bona fide hedging exemptions for all futures positions commonly used by market participants to hedge their physical commodity risk. Examples include futures used to hedge unpriced physical purchase or sale commitments or futures used to hedge physical transactions using calendar month average pricing. The final rule should also provide further guidance on whether, and to what extent, options may qualify as bona fide hedging transactions, which is not clear under the current Proposal. Explicit recognition of such eligibility in the final rule is important in order to provide end-users and consumers with certainty and clarity.

More generally, the bona fide hedging definition must not be overly restrictive in its application of the economically appropriate test such that it fails to recognize that firms may measure and hedge or manage risk at any of the enterprise, legal entity, desk, book, trader or asset level. ISDA appreciates the CFTC's Proposal to recognize this approach and encourages the CFTC to finalize a principles-based and practical approach, deferring to a firm's own certification, but subjecting those firms to further special call inquiry from the CFTC, as appropriate. The bona fide hedging definition should not be formulated so as to dictate the specific business model and methodology that a commercial market participant must follow in hedging and otherwise managing the risks arising from their business activities.

With respect to the CFTC's delegation to the exchanges of the ability to recognize non-enumerated bona fide hedging positions, the CFTC should include in any final rule clarification the factors exchanges should take into account, such as "sound commercial practices" or "necessary and appropriate to reduce potential threat of market manipulation." In addition, the CFTC should ensure that exchanges have the autonomy to efficiently review and grant exemptions, as appropriate, and without administrative delays.

Granting of Spread Exemptions Should be Administered Primarily by the Exchanges.

Similarly, the spread exemption guidance requiring market participants to apply both to the Commission and the applicable exchange for spread positions that do not fit within the spread transaction definition should be modified so that an application to the exchange alone suffices. The exchanges are better equipped with the experience, expertise, and staffing resources to manage this process, and the CFTC should not burden itself with functions that the exchanges can perform.

Avoid Burdensome Reporting Requirements for Bona Fide Hedge, Spread or Other Exemptions.

Any required or mandatory CFTC reporting of positions related to bona fide hedges, spread exemptions or other exemptions is burdensome and unnecessary, and ISDA encourages the Commission instead to rely on its special call authority and the ability of exchanges to seek additional information, on an as-needed basis. Consistent with this comment, ISDA supports the proposed elimination of the reporting burdens on Form 204 and parts of Form 304.

Request for Further Guidance on Swap Dealers' Monitoring Obligations.

With respect to the obligations of swap dealers to monitor position limits under 17 C.F.R § 23.601, the CFTC should (1) make these obligations less burdensome and (2) provide additional guidance on, and simplification of, the requirements. Section 23.601 includes prescriptive provisions that require swap dealers to, among other things, provide training to all relevant personnel on applicable position limits on an annual basis, implement an early warning system as part of its position limit procedures, report any detected violation of applicable position limits to its governing body, and report certain detected violations of applicable position limits to the Commission. The costs placed by this overly burdensome compliance regime on firms is not commensurate with its supposed benefits. Additionally, the Proposal does not identify what the early warning system should entail, or whether notice to a swap dealer's governing body is appropriate given that governing bodies of swap dealers would not typically see such information, nor does it specify the contents of the notice to the Commission. The lack of guidance renders compliance with Section 23.601 unnecessarily cumbersome and unworkable. ISDA believes that even if further clarification is provided, the proposed regime would still impose unnecessary burdens and costs on firms. In addition, the current Proposal's approach to position limits makes the quarterly testing and reporting obligations burdensome and costly. The Commission should consider including further clarification and/or interim relief in the final rule with respect to these requirements for swap dealers.

Review Position Limit Levels as Markets Evolve.

Under the current Proposal, prior to amending any of the proposed spot or non-spot month levels, if adopted, the Commission would provide for public notice and comment by publishing the proposed levels in the Federal Register. ISDA encourages the Commission to also include in any final rule a process in which the Commission must regularly convene and consult with exchanges on deliverable supply and, if appropriate, propose notice and comment rulemaking to adjust limit levels. This is needed in order to avoid limit levels becoming inappropriately low, stale, or otherwise imprecise in the context of changing markets and products.

Cross-Border Harmonization.

As the CFTC looks to finalize this Proposal, ISDA encourages the Commission to keep in mind its goal of cross-border coordination and harmonization. For example, the

European Union is in the process of reviewing MiFID II, including their own position limits rules, and they are requesting comment now on the failure to include appropriate exemptions for financial firms in the first attempt at implementation. The CFTC should take advantage of the EU's "lessons learned" on this subject and ensure that any U.S. rule includes an appropriate risk management exemption. Similarly, the CFTC must consider whether any limits that could apply to over-the-counter swaps could potentially have an impact on products and markets that trade largely outside of the United States. The CFTC must ensure that its limits do not become disruptive to the liquidity profile for products and market participants in other jurisdictions, just as ISDA encourages other jurisdictions to avoid rules that would unduly impact U.S. markets and market participants.

Finalize Aggregation Relief.

While the Proposal does not address aggregation, the CFTC should take the opportunity now to codify as rules the aggregation no-action relief that is relied upon by many market participants. Specifically, the CFTC should move to codify in its rules the relief in CFTC Letter 19-19, which extended the relief first granted in CFTC Letter 17-37.

Ensure Appropriate Exchange Set Limit Levels.

If an exchange determines to set its exchange limits significantly below the Federal position limits, market participants could be restricted in their ability to provide liquidity and otherwise pursue their trading objectives. This result could constitute an unwarranted restriction on trading and hedging activity, given that the CFTC will already have made its determination as to the appropriate levels. To the extent that an exchange determines to set position limits significantly below federal limits, ISDA encourages the CFTC staff, through its exchange examination process, to make transparent the exchange's reasoning and analysis underlying any lower position limits.

Ensure a Flexible Pass-Through Swap Exemption.

ISDA supports the Proposal's inclusion of pass-through swaps and pass-through swap offsets as bona fide hedging transactions. However, ISDA believes that the pass-through swap exemption can be clarified to make it more commercially practical and principles-based. As proposed, a dealer must demonstrate upon request that the pass-through swap qualifies as a bona fide hedging transaction for its counterparty.[10] The Proposal indicates that the Commission expects that counterparties will provide a representation that a swap is a bona fide hedge. The requirement to make the required demonstration about a position of a third party will lead to unique challenges for dealers. Although ISDA understands that many commercial end users likely will provide a bona fide hedging representation, that may not always be the case. Furthermore, when commencing a trading relationship, an end user may be unwilling to represent in advance that all of its swaps will be bona fide hedging transactions. Absent a prior blanket representation, a

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[10] See Proposal at 11,717 (proposed definition of bona fide hedging transactions or positions).

dealer must rely on the pass-through swap provision on a swap-by-swap basis, which is inefficient and commercially impractical.

ISDA believes that these practical considerations warrant a more flexible pass-through swap provision in the Proposal. It should be sufficient for a dealer to demonstrate that it had a reasonable, good faith basis to believe that, based upon the facts and circumstances, any particular swap qualifies as a bona fide hedging transaction. For example, a dealer could rely upon the fact that the counterparty is a commercial end user and that the swap appears to be consistent with hedges entered into by end users in the same line of business. By allowing for flexibility in how a dealer may demonstrate eligibility for the pass-through swap provision, the CFTC would increase the likelihood that dealers will be able to rely upon the provision, which will enhance liquidity for bona fide hedging counterparties.

Additionally, the Proposal should recognize that many firms manage and hedge risk at the enterprise and portfolio level, and not necessarily on the level of each individual trade. To that end, the Commission should make clear that the pass-through swap exemption applies on a portfolio basis rather than on a one-to-one basis. Doing so will allow firms to manage its offsets on a book basis, rather than requiring them to match and maintain individual contracts and the corresponding hedge, which is both challenging from a compliance perspective and commercially inefficient given the portfolio-based nature of many firms' trading strategies. Since many firms also aggregate positions across entities at the enterprise level, the Commission should also make clear that firms can similarly apply the pass-through swap exemption across entities within a group. Indeed, ISDA urges the CFTC to acknowledge more generally the enterprise-based derivatives management strategies and systems in place at many firms, and take this fact into account for exemptions more broadly.

Adjustments to Specific Position Limits.

ISDA urges the CFTC to ensure that the non-spot month limit for Kansas City Hard Red Winter Wheat futures contracts be raised to the same level as is finalized for the non-spot month limit for the CBOT Wheat contract. The physical market for wheat deliverable under the Kansas City wheat contract is larger than the market for wheat deliverable under the CBOT contract. The wheat deliverable under the Kansas City contract is also closer in composition to much of the global wheat supply, and the Kansas City contract is potentially a key hedging tool for much of that market. For these reasons, the CFTC should ensure that limit levels for the Kansas City wheat contract are set at the same levels as are set for the CBOT wheat contract, if not higher, in order to allow liquidity to enter this contract.

Conclusion

ISDA appreciates the opportunity to submit these comments and looks forward to working with the Commission as it prepares to issue final rules. To the extent ISDA can provide any additional information or materials that will assist in the CFTC's review of these comments, please do not hesitate to contact the undersigned.

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Sincerely,

Steven Kennedy
Global Head of Public Policy

Cc: Heath P. Tarbert, Chairman
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