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Via Electronic Submission

Christopher Kirkpatrick
Secretary of the Commission
U.S. Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, D.C. 20581

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

Dear Mr. Kirkpatrick:

The Commodity Markets Council ("CMC") appreciates the opportunity to submit comments on the Commodity Futures Trading Commission's ("CFTC" or "Commission") proposed rule implementing federal speculative position limits pursuant to provisions of the Wall Street Transparency and Accountability Act of 2010 ("Dodd-Frank").

CMC is a trade association that brings together exchanges and their industry counterparts. Its members include commercial end-users that utilize the futures and swaps markets for agriculture, energy, metal, and soft commodities. Its industry member firms also include regular users and members of swap execution facilities (each, a "SEF") as well as designated contract markets (each, a "DCM"), such as the Chicago Board of Trade, Chicago Mercantile Exchange, ICE Futures US, Minneapolis Grain Exchange, NASDAQ Futures, and the New York Mercantile Exchange. Along with these market participants, CMC members also include regulated derivatives exchanges and price reporting agencies.

CMC broadly supports the proposed rule and appreciates the Commission's fresh approach to implementing the position limits provisions of Dodd-Frank. The proposed rule responds to many of the end-user concerns about prior Commission proposals raised by CMC and others who use futures markets to hedge risk exposures related to commercial activities in physical commodities. CMC applauds the proposal for its implicit recognition that safeguarding market function is the paramount concern when implementing regulatory tools such as speculative position limits. While CMC is broadly supportive of the proposed rule, there are several provisions that in our view warrant change or clarification before the Commission adopts a final rule.

Background

CMC membership includes all of the regulated exchanges that list the 25 core referenced futures contracts to which federal speculative position limits would be imposed under the proposed rule. In addition, CMC members include commercial end-users in the physical commodities subject to speculative position limits, including: agricultural companies that originate, store, process, transport, market, and export grains, oilseeds, and soft commodities; energy companies that produce, store, refine, market, and transport crude oil, natural gas, electricity, environmental credits, and other refined products; and metals firms that trade

physical metals commodities. As such, CMC is uniquely positioned to reflect a broad industry consensus among the markets and those firms that use derivatives for their primary purposes – price discovery and risk management.

CMC members consider legislative and regulatory proposals primarily through the lens of market function. More specifically, how those proposals would affect the role of futures in price discovery and the management of commercial risks. It is through the effective performance of these dual-market functions that producers and consumers realize the economic benefits derived from these derivative markets.

Federal speculative position limits have been a regulatory tool in certain agricultural futures contracts for decades and independent exchange speculative limits and/or accountability levels have been employed in several other markets as a means of limiting the potential uneconomic effects of speculative liquidity. For some markets, these tools have been useful in promoting convergence between the futures and cash markets during spot-month trading and expiration of a futures contract.

CMC recognizes that Dodd-Frank envisions a more robust regulatory process for federal speculative position limits and its members well understand the associated policy and regulatory objectives. CMC members also see a need for a balanced rule to limit the potential costs of a speculative position limits regime, most notably: loss of liquidity that could harm contract performance; and lost commercial utility in hedging. CMC is particularly concerned about regulatory determinations that may potentially conflict with common economic and commercial risk management practices.

Executive Summary

CMC supports the Commission's overall approach taken in the proposed rule. The Commission's approach would improve the relationship of the rule to today's markets and provide necessary flexibility as markets continue to evolve. To that end, CMC appreciates the affirmative recognition of the need for regulatory flexibility to provide "broader discretion for market participants to measure risk in the manner most suitable for their business."[1]

CMC also respects the Commission's decision to undertake necessity findings to support its decisions and resulting position limits regime.

CMC is concerned that the proposed approach could result in several unintended consequences for the markets and their participants. The proposed rule intends to provide a more flexible approach, relying on increased deference to exchanges and market participants in assessing risk and recognizing strategies for hedging risk exposures. Portions of the preamble discussion, however, prompt questions about the expressed intent of the proposed rule and the potential implications for CMC members. CMC therefore suggests modifications to several areas of the proposed rule to provide the clarity necessary to achieve predictability in the rule. Broadly, the concerns go to the bona fide hedge definition, the Appendix A list of enumerated hedges, Appendix B guidance, and the measurement of risk.

Comments

A. <u>Definitions – Proposed Rule 150.1</u>

CMC supports most of the Commission's proposed definitions. They generally provide a sound framework for clarity in understanding of the proposed position limits regime. However, there are aspects of the

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[1] 85 FR 39 at 11598.

Commission's proposed bona fide hedging and pass-through swaps definitions that CMC believes would benefit from change or clarification.

1. Bona fide hedging – Proposed Rule 150.1

CMC supports the updated versions of the temporary substitute test, economically appropriate test, and change in value requirements, as well as the elimination of the incidental test and orderly trading requirement, subject to the Commission addressing the following concerns.

The Economically Appropriate Test: The Commission proposes to amend the economically appropriate test by incorporating "price risk" to the definition that historically has been "risk."[2] As a general proposition, CMC is not opposed to the addition of "price" as a qualifier to "risk." However, it is CMC's view that "price risk" is not an absolute objective measure[3] and consequently the term must incorporate a commercial hedger's independent economic assessment of price risk.

If the CFTC's intent is to suggest that risk is static, then the qualifier is inappropriate as it cannot reasonably be disputed that outside events must be independently considered by market participants as potential price risk exposures to their commercial activities. These events are not "non-price risks" per se, but are rather events that affect price risk exposures, including geopolitical, weather, and pandemic risks.

We therefore ask the Commission to remove the word "price" from its proposed economically appropriate test. Alternatively, CMC requests that the Commission's definition include a broad construction of "price risk", thus acknowledging that it is a permitted objective to trade in response to the events described herein and that those transactions be recognized as bona fide hedges because the events and the risks they present affect commodity prices.

Proposed Enumerated Bona Fide Hedges for Physical Commodities: The Commission proposes a significant expansion of the list of enumerated hedges. CMC strongly endorses the Commission's proposed approach to expand the list of enumerated hedges and make them self-effectuating. However, as discussed here and below in Section 3, CMC believes the list of enumerated hedges remains incomplete and warrants further expansion and clarification. Moreover, as laid out

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[2] *Id.* at 11606.

[3] The Commission seems to stake out a position that there is always a single, absolute objective measure for assessing whether a position is reducing price risk.

> While the Commission or an exchange's staff can objectively evaluate whether a particular derivatives position is an economically appropriate hedge of a price risk arising from an underlying cash-market transaction, including by assessing the correlations between the risk and the derivatives position, it would be more difficult, if not impossible, to objectively determine whether an offset of non-price risk is economically appropriate for the underlying risk. For example, for any given … political risk, there could be multiple commodities, directions, and contract months which a … participant may view as an economically appropriate offset … market participants might take different views on which offset is the most effective . . . . *Id.*

This is precisely the point. Effective price risk management must be dynamic and respond to outside events in real time – there are few absolutes and a great deal of subjectivity. Commercial end-users view real-world events through the prism of managing against price risk exposures to their commercial activities. They will have differing opinions that shape their hedging activities; this defines the market – a collection of independent perspectives about the price risks to commercial activities arising from market fundamentals and outside events such as geopolitical, weather, logistics, or more currently, pandemics. The term "price risk" must incorporate a commercial hedger's independent economic assessment of price risk.

immediately below, CMC is concerned that the Commission's stated objective of a self-effectuating regime is less than clear.

a. With respect to the list of enumerated hedges, the Commission should expand the list of enumerated hedges to include hedges of either unfixed priced purchases or sales (BFH Petition Example #3),[4] as well as basis purchases or sales.[5] The Commission has recognized the risk that merchants face when purchasing and selling physical commodities on an unfixed price basis that are indexed to different futures months. As such, the Commission is reproposing an enumerated hedge whenever a merchant has both purchased and sold physical commodities on an unfixed price basis and indexed to different futures months. Because merchants will often sell commodities well in advance of purchasing them, in response to the needs of their customers, merchants with only unfixed priced sales are exposed to the exact same calendar month spread risk as merchants that have executed both unfixed price legs of the transaction, because any futures market calendar month spread convergence or divergence will affect both scenarios in exactly the same manner. Examples of such risk management strategies are included in Section 3 below. We urge the Commission's renewed consideration of these hedging activities and request their incorporation into the list of enumerated hedges either independently, by changing the definition of unfixed price purchases/sales to include either purchases or sales, or, alternatively, by including them as anticipatory merchandising hedges. CMC believes these unfixed price activities meet the guidance provided for anticipatory merchandising hedges and should therefore be accepted.

b. CMC is concerned that the preamble's discussion of the enumerated hedge for anticipatory merchandising might render such enumerated hedges conditional at best and partially undercut the self-effectuating regime the Commission intends. CMC also believes the definition of "merchant" warrants clarification.

   The Commission's proposed rule includes anticipated merchandising in the list of enumerated hedges and provides a regulatory framework for the analysis of such hedging activities.[6] However, Footnote 105 of the proposal seems to ignore the process and declares that anticipatory merchandising hedging for "storage hedges and hedges of assets owned or anticipated to be owned" would not be considered as anticipatory merchandising and therefore not enumerated under the proposed rule.[7] Rather, these hedges of anticipated merchandising activities would be subject to case-by-case review as non-enumerated hedges. To be generous, the exception seems to eviscerate the intended addition of anticipated merchandising activities in the list of enumerated hedges.[8]

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[4] The Working Group of Commercial Energy Firms' BFH Petition is available at https://www.cftc.gov/sites/default/files/stellent/groups/public/@rulesandproducts/documents/ifdocs/wgbfhpetition012012.pdf. The Working Group of Commercial Energy Firms has since reconstituted itself as the "Commercial Energy Working Group."

[5] This section responds to Question #2 of the Commission's proposed rule. 85 FR 39 at 11622.

[6] *Id.* at 11610.

[7] *Id.* at 11612.

[8] The Commission justifies this outcome by relying on long-held staff views as described in the Commission's 2016 reproposal. CMC suggests that the Commission's reliance on staff views, which date back prior to the enactment of Dodd-Frank, are erroneous and violate the express provisions of law. While it is true that anticipatory merchandising activities were not specifically included as bona fide hedges under the Commission's pre-Dodd-Frank effective Rule 1.3(z), it is equally and more substantively true that anticipatory merchandising activities are expressly included in the bona fide hedge definition adopted by Congress in Dodd-Frank.

CMC members have been consistent in their advocacy for the Commission to simply follow the law with respect to the recognition of anticipatory merchandising hedging practices. To the extent the Commission believes limits are necessary, it must be clear with the exchanges and the end-user community about what activities are enumerated.

The limitations expressed in Footnote 105 are significant and cast a shadow of uncertainty especially as they relate to anticipatory merchandising hedges.

CMC notes with approval the Commission's decision to withdraw the 2013 proposal and 2016 reproposal of the proposed position limits rule. However, Footnote 105 references examples presented to the Commission through those rule making processes. CMC would be concerned, for example, if the Commission's proposed interpretations of Rule 1.48 carry forward into a final rule. The 2013 proposal and 2016 reproposal deviated from well-established commercial practices under previously granted CFTC exemptions, pursuant to §1.48, and concluded that soybean processors could only avail themselves of the anticipatory processor's exemption if they held equivalent positions in each of the three legs of the hedge.[9] CMC reiterates that such a conclusion would fail to understand the commercial economics of price risk at any given time, substituting instead an arbitrary regulatory determination of price risk.

CMC requests that the Commission be clear and rely on the processes it proposes to establish for enumerated hedges that are truly self-effectuating.

CMC further requests that the Commission make clear that "merchant" includes integrated firms that perform merchandising in addition to other activities. For example, a firm engaged in the exploration and production of hydrocarbons may have a division devoted to the marketing and trading of the related commodities. In this sense, the company is acting as a merchant and should have access to the anticipatory merchandising hedge. However, one may not describe the enterprise, taken as a whole, as a merchant in the first instance.

Elimination of a Federal Five-Day Rule: CMC applauds the elimination of the five-day rule. Our members have previously expressed concerns about the expansion of the five-day rule to all markets subject to federal position limits; therefore, we support the elimination of the federal five-day rule.

CMC views the five-day rule as a potential tool for exchanges to manage their markets in the final days of the delivery period. To that end, we support the views expressed by the CME Group urging that the Commission remove the guidance in Appendix B around positions held in the spot month. We agree that the proposed guidance is unclear and could result in unnecessary burdens and costs to market participants.

2. Pass-Through Swaps

CMC supports allowing swap dealers to claim hedge treatment for futures positions held against swap exposures with counterparties whose swap position itself is a bona fide hedge of commodity risk exposures. The provisions for pass-through swaps make good sense in that they reflect the market and encourage risk management on the part of end-users. CMC is concerned, however, about the potential operational burden of documenting pass-through swaps. While we appreciate

[9] 81 FR 96748.

the Commission's interest in preventing abuse, we believe written confirmations and cash market documentation as contemplated are unnecessary. CMC requests that the Commission revise the proposal to allow swap dealers to claim bona fide hedging status for pass-through swaps based on a reasonable reliance on counterparty representations.

B. Federal speculative position limits – Proposed Rule 150.2

The Commission proposes federal speculative position limits in the spot months for all 25 core referenced futures contracts, their referenced contracts, and their economically-equivalent swaps. Federal limits outside of the spot month would only apply to the nine legacy agricultural futures contracts. CMC agrees with this approach.

CMC is generally supportive of the proposed increases to speculative position limits for the identified metals, energy, and agricultural markets covered by the rule. Speculative liquidity is critical to enabling markets to perform the functions of price discovery and risk management. CMC believes the proposed limits in energy and metals markets are appropriate and should be implemented as proposed.

CMC, however, urges the Commission to consider phasing in the limits for agricultural commodities to assess the impact increased limits may have on contract performance. As the Commission noted in its proposal, production of the underlying commodities has generally increased and open interest in the related futures contracts has grown in the years since the limits were revisited. Yet, there remain concerns that some agricultural markets may be more susceptible to market disruptions in part because the underlying cash markets are not as deep as other commodity markets. A phased approach could provide market participants, exchanges, and the Commission a way to build in scheduled pauses to evaluate the effects of increased limits, thereby fostering confidence and trust in the markets.

C. Exemptions from Federal Position Limits – Proposed Rule 150.3

As previously discussed, CMC generally supports the Commission's approach to the framework for the recognition of exemptions from position limits. The envisioned deference to exchanges would promote efficiency by incorporating many of the existing processes into the annual hedge exemption renewal processes, while still maintaining effective oversight controls by requiring the maintenance of fulsome books and records.

CMC offers the following observations and suggestions for modification that we believe will strengthen the exemption provisions and deliver on the Commission's objectives.

1. **Bona Fide Hedging Positions and Appendix A:** Overall, the Commission has proposed a welcomed approach to bona fide hedging exemptions. The Commission proposes placing recognized enumerated hedges into a new Appendix A and has asked for comments. As presented, there does not appear to be any regulatory difference in embedding the enumerated hedges in the rule or placing them in what would be Appendix A. We understand that updating Appendix A would require the same formal rulemaking procedures as amending the rule. It may be that the appendix format would be a simpler reference for the industry. The appendix format would be more dynamic if the Commission could provide two additional provisions: (1) a process for which non-enumerated hedges can be added to the list of enumerated hedges (and Appendix A) where appropriate; and (2) an annual update to Appendix A under an expedited process (subject always to notice and comment to market participants).

2. **Spread Positions:** CMC supports the inclusion of spread positions as exempt from position limits. Such positions are commonly used in the management of risks in commercial enterprises. We

encourage the Commission to clarify that, for purposes of exchange-level position limits, each exchange has the discretion regarding what information firms might provide to support the granting of spread positions for compliance with exchange-level position limits. Moreover, the final rule would benefit from an affirmative statement that exchanges are not responsible for monitoring the use of spread positions for purposes of federal position limits.

Finally, CMC supports the inclusion of two specific kinds of spread transactions in the exemption for spreads. First, CMC endorses the ICE's request that cash and carry spreads in coffee, cocoa, and FCOJ not be excluded from the exemption for calendar spreads. Cash and carry spreads have a long history of economic utility in these markets and reflect their underlying characteristics. Second, CMC requests the CFTC to identify spreads between two exchanges in related contracts as appropriate spreads for exemptions from the federal position limit regime. Firms often use such spreads to adjust risk mitigation positions to perceived sources of trading liquidity.

3. **Anticipatory Merchandising Hedges:**

In the physical commodity merchandising business, there typically is a time lag between the procurement of a physical commodity from a producer and the ultimate sale to an end-user. When purchasing a physical commodity, a merchant is generally taking delivery within an interior location in the U.S. For instance, when a merchant is purchasing cotton, the merchant is generally purchasing on an ex-warehouse basis in one of approximately 350 licensed warehouses in the geographic interior of the U.S. Sales of cotton are mostly exported and are generally sold either on Cost and Freight ("CFR") or Cost, Insurance, Freight ("CIF") terms. Under these terms, the merchant must load the cotton onto a ship at a U.S. port and ship the cotton to the end-user.

In order to fulfill the sale, the merchant must first procure the physical commodity in an interior warehouse, order the cotton out of the interior warehouse, stuff the cotton into a container, transport the cotton to a U.S. port and load the container onto an ocean-going vessel. This time lag generally averages between two and three months, thus in almost all cases, a merchant must purchase inventory indexed to one futures month, and sell the inventory to an end-user indexed to a subsequent futures month. This time lag creates calendar month spread risk that the merchant must hedge.

The Commission should clarify that, when a commercial firm executes the initial short or long futures position in respect of either a cash commodity purchase or sales contract, which it will later couple with another future for a related cash commodity transaction, the first position should qualify as an anticipatory merchandising hedge. If the hedge is still in place entering the delivery period, the relevant exchange can assess the appropriateness of the hedge.

EXAMPLES:

a. *Cotton Merchant Utilizing an Anticipatory Merchandising Hedge to Manage Calendar Spread Risk*

During the month of December, Merchant ("M") enters into a contract to sell cotton to a textile mill in Vietnam ("V") on a CIF basis, to be shipped in the month of April, at a floating price basis to the May cotton futures contract ("futures"). V has the right to fix its floating price at any time prior to First Notice Day on the May futures contract, which is in late April.

M will need to procure cotton, have it stuffed into a container, and loaded on an ocean-going vessel prior to the end of April. Because of the inherent time lag between the sale to V and the timing of cotton procurement, M will need to utilize the March futures contract for supply risk protection. However, since M's best option for supply risk protection is via March futures and the sale commitment is priced basis to May futures, M is exposed to calendar month spread risk. In order to hedge this risk, M would need to buy the March futures and sell the May futures. As often happens in the merchandizing of commodities, the merchandizing firm may not have a physical contract to source the commodity at the same time as its purchaser purchases the commodity.

As the March contract approaches delivery, M will evaluate whether: (i) it is more economical and appropriate under the circumstances to purchase cotton in the physical market and to liquidate the long March futures; or (ii) to source cotton by taking delivery of March futures. If M is able to purchase fixed-price cotton in the physical market, M will sell March futures, thereby exiting the long futures position that was established. However, as long as sourcing cotton through the delivery market is more economical and appropriate under the circumstances than purchasing cotton in the cash market, M needs the ability to continue to hold the March futures position and to take delivery in order to fulfill its sale commitments.

b. *Grain Merchandising*

A local grain elevator anticipates buying grain from a farmer who will have a crop for sale in May, but who does not want to lock in a price too early. The farmer agrees to sell to the elevator at a differential to the futures price (*e.g.*, 3 cents above the May futures price). The grain elevator might hedge its unfixed price risk with long May futures. This could be done before or after agreeing to an unfixed price purchase from the farmer. When the parties agree to decide to "fix" the price of the grain, they engage in an exchange for physical transaction in which the elevator accepts a short May futures position that offsets its hedge.

That same grain elevator also anticipates selling grain in July based on a differential to the futures price (*e.g.*, 5 cents above the July futures price). The grain elevator would hedge the July sale with short July futures. When the elevator and a purchaser decide to "fix" the price of the grain, they enter into an exchange for physical transaction, resulting in the elevator accepting a long futures position that offsets its hedge.

In this example, the elevator uses futures to facilitate its business of accumulating commodities today and for the later sale of those commodities. Yet, if the purchase and sales contracts are priced to index, the elevator is not hedging fixed-price risk as described under the proposed position limits rule. More accurately, it is managing a timing difference between receiving July contracts for commodities for which it will deliver May contracts. Because the elevator may be making rational, commercial decisions about pricing purchases at a different time when pricing sales, the enumerated bona fide hedge for offsetting floating price contracts may not be available to it. Moreover, the elevator may have a reasonable anticipation of volumes over more than one sales contract. It would be unduly burdensome if the elevator had to manage risk associated only with *actual* sales and, therefore, more logical to permit the elevator to manage risk associated with its *anticipated* sales. The cash and futures activities described reflect commercial practices. It is unclear, however, whether these hedging activities would be considered bona fide hedges under the self-effectuating anticipatory merchandising hedge definition.

c. Soybean Exports

The following transaction is an example of what has been the standard of international grain merchandising for many years.

On January 22, 2019, Merchant enters into a contract to sell 4 cargoes (vessels) of soybeans to a counterparty in Asia ("Customer"). The total number of bushels of soybeans sold to Customer is 8 million, or the equivalent of 1,600 futures contracts. Terms of the contract are as follows:

- FOB Vessel – New Orleans, Louisiana (*i.e.*, shipper is responsible for delivering the soybeans to the port of New Orleans and loading the soybeans on the boat).
- First half May 2019 delivery.
- Price: 75 cents over the May 2019 CBOT Soybean futures contract.

Customer has the option to fix the price by transferring May 2019 futures to Merchant via an "Exchange for Physical," or EFP, prior to May 1, 2019.

Merchant will need to purchase 4 cargoes of soybeans and transport them to the export elevator in New Orleans, Louisiana in time to load four vessels in the first half of May 2019. Merchant must decide how best to procure the soybeans for the sale to Customer. The May 2019 futures contract will not provide supply protection for Merchant's commitment to Customer because the CBOT futures delivery for May 2019 soybeans is not in time to satisfy Merchant's contractual commitment. Merchant therefore needs time protection to cover its sale and decides that the March 2019 futures contract is the best solution.

On the date of the sale to Customer, the CBOT futures price for March 2019 soybeans was $9.72 per bushel, and the CBOT futures price of May 2019 soybeans was $9.79 per bushel. Thus, the March 2019 contract was priced seven cents per bushel below the May 2019 contract. Because the Merchant's best supply protection is the March 2019 futures contract and the commitment to Customer is indexed to the May 2019 futures contract, Merchant is exposed to calendar spread risk. If the March futures contract were to narrow or go above the May futures contract, the transaction with Customer could incur large losses. Merchant decides to protect its commitment to Customer and lock in the discounted price of the March futures contract compared to the May futures contract by purchasing 1,600 March 2019 futures and selling 1,600 May 2019 futures.

Merchant will eventually receive 1,600 long May 2019 futures from Customer via an EFP whenever Customer decides to fix its purchase contract prior to May 1, 2019. Merchant's short May 2019 futures position will be offset by the long futures received from Customer.

Merchant begins purchasing soybeans in the most economically appropriate manner. Merchant procures from various sources in the physical market. As Merchant purchases soybeans on fixed-price basis and as unfixed price sellers fix their sales, Merchant sells March 2019 futures to offset its long March 2019 futures.

The hedging strategy, however, would not receive treatment as a bona fide hedge under the Proposed Rule because the Merchant, when putting on the futures positions does not have two offsetting cash market transactions that correspond to the future positions. This could result in a less efficient export transaction (*i.e.*, higher prices quoted to the importer and lower prices quoted to the domestic sellers) and impede convergence of futures and physical markets.

The Commission's reasoning for denying bona fide hedging treatment is based on the sole fact that the sales contract to Customer was not a fixed price commitment at the time of the hedge by the Merchant. The consequences of the Commission's narrow interpretation of bona fide hedging will force Merchant to change the manner in which it merchandises to end-users. Merchant, in order to protect its ability to utilize futures as a hedge against physical supply commitments, may be forced to contractually require Customer to fix its May 2019 soybean contract by "first notice day" of the March 2019 soybean futures contract. Thus, in effect, the unintended consequence of this rule change may be that the Commission is mandating the date by which the end-user prices its soybeans.

d. *Winter Storage of Natural Gas (presented at a CFTC Roundtable February 26, 2015)*

A natural gas supplier in April 2013, leases storage in order to store and provide gas during the 2015-2016 winter season. Assume the supplier leased storage and his/her expected cost for storage is 38 cents per MMBTU, but in June 2013, market conditions are such that s/he is able to lock in a profit associated with that storage by using the futures markets. The supplier can buy October 2015 gas on the market for $4.299 per MMBTU and can sell gas, which would come out of storage in January 2016, for $4.69 per MMBTU. The supplier enters into that transaction in the futures markets by buying October natural gas futures and selling January natural gas futures, and locks in that differential.

Neither the October nor the January futures contracts would qualify for bona fide hedge treatment under the proposed rule. But in September 2015, when the natural gas physical market is active, the supplier is going to buy the gas that s/he will use to fill his/her storage in October 2015. When this occurs, the supplier will liquidate his/her October natural gas futures contract. In December 2015, when the supplier needs to supply his/her customers (*i.e.*, local utilities), s/he will sell the gas to be withdrawn from storage and liquidate the January natural gas futures contracts.

This storage transaction should be given bona fide hedging treatment because it satisfies the statutory standards established by Congress – it was a substitute for transactions to be made at a later time in a physical marketing channel, *i.e.*, the purchase of natural gas to fill storage and a sale to withdraw from storage – which was economically appropriate to the reduction of the supplier's risk that s/he will be able to recover the cost of its storage obligation and separately that s/he can profit from his/her business of supplying gas in the winter. This arose from the potential change in the value of an asset (natural gas storage) that the supplier owned and the gas itself that s/he anticipated owning. Consumers benefit from this transaction because it assures that gas will be in storage during the 2015-2016 winter heating season. The supplier would not have entered into the transaction to commit to storage without the ability to hedge his/her risk. The supplier wants to hedge the value of his/her storage not yet leased. If the prices move against him/her, s/he will not lease that storage, but the futures markets allow him/her to lock in the value of his/her asset by hedging in the futures markets.

4. **Elimination of §§ 1.47, 1.48 and 140.97:** CMC supports the elimination of §§1.47 (recognition of non-enumerated hedges), 1.48 (the anticipatory processor's hedge exemption) and 140.97 (delegated authority for determining classification as bona fide).

   The Commission's proposal to incorporate updated processes to recognize non-enumerated hedges – especially the addition of an exchange process under proposed §150.9 – into proposed Rule 150 is appreciated and makes good sense.

CMC also appreciates the Commission's determination to include anticipatory bona fide hedges, formerly issued pursuant to §1.48, as enumerated under the proposed rule thereby no longer requiring Commission approval. CMC notes that exemptions previously granted under §1.48 were unpublished and individual to each applicant. We encourage the Commission to defer determinations related to anticipatory processing hedges to the exchanges, pursuant to the proposed rule's overall hedge exemption framework.

5. **Previously-Granted Risk Management Exemptions:** CMC is comfortable with the Commission's preliminary determination that bona fide hedge exemptions are limited under Dodd-Frank to transactions that represent a substitute for transactions or positions to be taken in a physical commodity marketing channel. CMC understands that this could have an effect on futures market liquidity. We are optimistic, however, that the substantial increase in overall speculative position limits and allowances for pass-through swaps will limit any potential loss of liquidity.

6. **Miscellaneous Issues:** CMC members are concerned about the following miscellaneous items.

    a. The guidance is vague regarding what is necessary for a market participant to demonstrate a sudden and unforeseen increase in its need for a non-enumerated bona fide hedge after it exceeds a federal limit without an exemption. CMC agrees with the views expressed by the CME Group in its comments that applicants for these retroactive exemptions should not be required to submit "an explanation of the circumstances warranting the sudden or unforeseen increase in bona fide hedging needs."[10] CMC believes this is another example where the Commission can rely on the experience of the exchanges and their closeness to the markets.

    b. It appears from the proposed rule that the Commission expects end-users to submit full factual and ***legal*** analyses to support hedge exemption requests for both the initial requests and subsequent annual renewals for exchange level position limit regimes. CMC understands the Commission's requirement for a full legal analysis to support an initial request for a hedge exemption or for requests to recognize additional exemptions in subsequent requests. In light of the redundancy and likely substantial costs, CMC fails to see the need for full legal analysis of annual hedge exemption renewals submitted to the exchanges. Once recognized as bona fide, CMC believes it sufficient to provide full factual information to the exchanges to support previously authorized trading activities under the hedge exemption. CMC therefore requests that the Commission clarify that it will not require hedgers to submit full legal analyses for applications to renew previously granted hedge exemptions, or, in the alternative, clarify that exchanges or the Commission might request legal analyses at their discretion, which may be in the form of analysis provided by in-house counsel.

D. Process for Recognizing Non-enumerated Bona Fide Hedging Transactions or Positions with Respect to Federal Speculative Position Limits – Proposed Rule 150.9

As previously stated, CMC broadly supports the proposed deference to the exchanges in assessing a market participant's request to recognize as bona fide hedging transactions not included in the list of enumerated hedging transactions of proposed §150.3.

[10] 85 FR 39 at 11721.

The process envisioned in Proposed Rule 150.9, however, lacks clarity in some respects, and CMC requests further Commission consideration of these issues prior to issuing final rule.

Specifically, CMC believes the proposal is unclear about whether an applicant who receives approval of a non-enumerated hedge from an exchange may enter into transactions under the hedge exemption prior to expiration of the 10-day/2-day review periods for the Commission. CMC believes commercial end-users should be allowed to trade during that review period and rely on the exemption granted at the exchange level. Further, in the event the Commission disagrees with the exchange's approval and disapproves the hedge exemption, the applicant should be allowed a commercially reasonable time to exit the positions and should not be considered to have been in violation of any exchange or federal limits during the review period.

CMC also supports comments submitted by the CME Group recommending a phasing-in of the proposed exchange-administered process. Commercial end-users currently respond to a rigorous annual process to renew hedge exemptions with the exchanges. The process is time intensive and works well for the exchanges and individual hedgers because the renewals are spread out over the course of the year. CMC would be concerned about an implementation that in practice resulted in single renewal dates for all market hedgers. CMC believes the current practice and process should be endorsed, and we urge the Commission to work with the exchanges to phase-in the process in a manner that will be least disruptive to the market.

E. Part 19 and Related Provisions – Reporting of Cash-Market Positions

CMC members appreciate the Commission's consideration of the various reports that have been a part of the existing position limits framework for the nine legacy agricultural futures markets. CMC fully supports the Commission's proposal to eliminate Form 204. We agree with the Commission's conclusions that it can rely on information provided to the exchanges annually and perhaps more importantly on the real-time information that holders of hedge exemptions are required to maintain as a part of the recordkeeping obligations in §150.3.

CMC further supports the proposed revisions to Form 304. Moreover, CMC urges the Commission to eliminate Form 304 altogether. The Commission has requested comment related to the purpose, utility, and need for the on-call report information. We agree with the comments of the American Cotton Shippers Association's (ACSA) analysis on these points and conclude that changes in the market may make continued publication more, not less, disruptive to the underlying commercial markets in cotton. To the extent there is a strong policy reason to collect the information, we believe it should be to support the Commission's internal market surveillance activities and should not be released to the public.

F. The Commission Should Propose Amendments to it Aggregation Rules

Although the proposed rule does not address the requirements in Rule 150.4, CMC requests that the Commission address its position limits aggregation rules in a separate proposed rulemaking as soon as possible. The rules dictating how market participants must aggregate positions subject to a federal limit are a key component for compliance with the proposed rule. Commission staff issued no-action letter 19-19 (July 31, 2019) that significantly streamlined the conditions for a market participant to rely upon certain exemptions from the aggregation requirements. CMC recommends that the Commission promptly take steps to codify this no-action relief. Furthermore, CMC asks the Commission to revisit certain aspects of the aggregation rules and disaggregation relief based on issues and challenges that market participants encounter in practice. In particular, CMC believes it is appropriate for the Commission to reevaluate the threshold ownership percentage that triggers the requirement to aggregate positions in referenced contracts or to rely upon an exemption from the aggregation requirement.

The Commission's proposed definition of "eligible affiliates" incorporates a majority ownership concept, suggesting that it is appropriate to reevaluate the use of the 10 percent threshold as a proxy for control. The definition is relevant for purposes of proposed Rule 150.2(k), which allows an eligible affiliate that relies on aggregation relief under the rule to opt back into aggregating with its affiliates, recognizing there could be circumstances when that is beneficial. If a person has to meet a majority ownership standard to qualify for this benefit, it is fair to ask why a higher standard does not apply in the first instance to delineate those who have to aggregate based on ownership of an owned entity.

Conclusion

CMC appreciates the opportunity to comment on the proposed rule implementing federal speculative position limits. If you have any questions about these comments, or we can provide further information, please do not hesitate to contact me at Kevin.Batteh@Commoditymkts.org.

Sincerely,

/s/ Kevin K. Batteh

Kevin Batteh
General Counsel
Commodity Markets Council