May 15, 2020

Via Electronic Submission: http://comments.cftc.gov

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

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

Dear Mr. Kirkpatrick:

Citadel[1] appreciates the opportunity to provide comments to the Commodity Futures Trading Commission (the "Commission") on its notice of proposed rulemaking on *Position Limits for Derivatives* (the "Proposed Rule").[2] We generally support the Proposed Rule but urge the Commission to make certain modifications as further outlined below, which we believe will better align the position limits regime with relevant statutory goals.[3]

Investors play an essential and beneficial role in the commodities markets. Commodity market investors perform extensive fundamental research and analysis, examining troves of data and conducting detailed modeling of market trends and dynamics, to guide their investing activity. By bringing their informed investment decisions to the marketplace, investors contribute meaningfully to the price formation and discovery process. This in turn facilitates more efficient economic decisions by commodity producers and consumers and optimizes resource allocation across the real economy. Efficient commodity markets optimize economic output by informing the forward capital investment and resource allocation decisions of farmers planting crops or energy producers drilling new wells, among others.

Investors are also critical to commodity market liquidity. Commodity producers and direct consumers of those commodities only "meet" directly, if at all, by chance given the different sizes,

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[1] Citadel is one of the world's leading alternative investment managers. Citadel manages the capital of prominent investors from around the world including retirement programs, endowments and foundations, and sovereign wealth funds. For more information, visit www.Citadel.com.

[2] Position Limits for Derivatives, 85 Fed. Reg. 11596 (proposed Feb. 27, 2020), *available at* https://www.cftc.gov/sites/default/files/2020/02/2020-02320a.pdf.

[3] Section 4a(a)(3)(B) of the Commodity Exchange Act ("CEA") states that any position limits must achieve the following four statutory goals: (i) to diminish, eliminate, or prevent excessive speculation; (ii) to deter and prevent market manipulation, squeezes, and corners; (iii) to ensure sufficient market liquidity for bona fide hedgers; and (iv) to ensure that the price discovery function of the underlying market is not disrupted. 7 U.S.C. § 6a(a)(3)(B).

durations, and specifications of their risk management needs, and the size of the marketplace. Instead, investors, market makers and others provide needed liquidity to enable producers and consumers to hedge their risks and achieve their commercial goals. The availability of investor capital to take both long and short positions, assimilate copious amounts of information, and express countervailing views, creates deep, liquid and efficient markets.

Position limits therefore should be appropriately tailored and calibrated to reflect the valuable role that investors play in the commodity markets. We believe our following recommendations below will help achieve that goal.

I. Necessity Finding

A. We support the Commission's conclusion that a necessity finding is required before any position limit may be imposed.

We agree with the Commission's preliminary conclusion that "[CEA] section 4a(a)(2)(A) should be interpreted to require that before establishing position limits, the Commission must determine that limits are necessary."[4] The plain language of CEA section 4a(a) requires that position limits be set "as the Commission finds are necessary."[5] As noted in our previous comment letter, we believe that the addition of the "as appropriate" standard in CEA 4a(a)(2)(A) does not relieve the Commission of its obligation to make a necessity finding prior to establishing position limits.[6] We commend the Commission for interpreting CEA section 4a(a) in a manner consistent with the text of the statute and the Commission's history and experience.

B. A specific necessity finding on a commodity-by-commodity basis is required before a position limit may be imposed on a particular commodity market.

In the Proposed Rule, the Commission has preliminarily found that spot month position limits are necessary for the 25 core referenced futures contracts and any associated referenced contracts.[7] The Commission also has preliminarily found that, except for the nine legacy agricultural commodities, position limits in the non-spot month for the balance of the referenced contracts are not "necessary."[8] Although we support the Commission's decision to predicate a federal position limit only upon a finding of necessity, we believe that the Commission must provide a more targeted necessity finding by (i) evaluating the need for a limit on a commodity-by-commodity basis and (ii) establishing when and how holding a large position in a given commodity could allow a market participant to exert undue market power or influence.

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[4] *See* Proposed Rule at 11603.

[5] CEA section 4a(a)(1); 7 U.S.C. § 6a(a)(1).

[6] *See* Letter from Citadel to the Commission Re: Position Limits for Derivatives (RIN 3038-AD99), dated February 10, 2014 [hereinafter "2014 Comment Letter"], at 3, available at https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=59717&SearchText=.

[7] *See* Proposed Rule at 11664.

[8] *See* Proposed Rule at 11628-29 and 11664 n.459.

CEA section 4a(a) requires that any position limit the Commission imposes be "necessary to diminish, eliminate, or prevent" "an undue and unnecessary burden" on commodity markets arising from "[e]xcessive speculation."[9] Moreover, any position limit must be not only "necessary" but also "appropriate."[10] To satisfy these statutory requirements, the Commission's necessity finding should be informed by current market data that are germane to a specific commodity market. Only by considering market data specific to a particular commodity market can the Commission appropriately tailor its necessity finding.[11]

Further, the Commission should articulate the basis upon which a prescribed limit is necessary to prevent the exercise of undue market influence. Instead, the Commission posits that large positions could cause "sudden or unreasonable fluctuations in the price of"[12] a commodity, though concedes that "volatility is sometimes warranted in the sense that it reflects legitimate forces of supply and demand, which can sometimes change very quickly."[13] The Commission should equally consider the fact that the ability of well-informed investors to take substantial positions can offset or mitigate the price impact of uninformed speculation, as history is replete with examples of speculative bubbles caused by the collective activity of a large number of smaller market participants.

The Proposed Rule's necessity findings, however, rely on broad generalizations and general economic measures, such as statistics on production, trade, and manufacturing of the selected commodities.[14] In particular, the Proposed Rule identifies two "key features" that justify imposing position limits on referenced contracts across the 25 commodity markets: "the role they play in the price discovery process for their respective underlying commodities, and the fact that they require physical delivery of the underlying commodity."[15] The Commission thus appears to be proposing position limits on certain markets based merely on their size or importance.

Missing from the Commission's proffered justifications is any explanation of why the size or importance of each market, without more, would justify imposing position limits. To be sure, the Commission observes that position limits might be necessary as a prophylactic measure given the importance of these markets.[16] The problem, however, is that by relying on the general size and importance of the markets as the basis for the necessity findings in the Proposed Rule, without more, the Commission could set a questionable precedent that could be used later to justify imposing position limits on additional commodity markets without carefully examining the nature and conditions of the particular market and whether position limits are indeed necessary.

The Proposed Rule's lack of tailoring is also reflected in the Commission's proposed necessity findings in three commodity categories—agricultural, metal and energy. We believe that

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[9] CEA section 4a(a)(1); 7 U.S.C. § 6a(a)(1).

[10] 7 U.S.C. § 6a(a)(2)(A), (3) and (5).

[11] *See* 2014 Comment Letter, *supra* note 6, at 4.

[12] *See* Proposed Rule at 11667

[13] *See* Proposed Rule at 11667.

[14] *See* Proposed Rule at 11666-70.

[15] *See* Proposed Rule at 11666-67.

[16] *See* Proposed Rule at 11665.

the Commission should provide a specific analysis of each commodity market to justify why a position limit would be necessary, as required by the statute. A commodity-by-commodity analysis would also be consistent with the previous and longstanding practice of the CFTC and its predecessor, the Commodity Exchange Commission, dating back as far as 1938.[17]

Imposition of position limits, without an adequate necessity finding backed by a careful examination of each commodity market, could limit the essential role investors play in the commodity markets. Reduced investor participation would impair the ability of commodity producers and consumers to manage risk and make optimally informed commercial decisions with respect to planting crops and drilling wells, among others. Such an outcome would run counter to the congressional purposes of position limits.

Even assuming the Commission's rationale for the proposed limits on the 25 commodity markets is sufficient if limited to those markets, however, those same findings cannot serve as the basis for imposing spot-month position limits on any other commodities or for imposing non-spot month position limits except for those already applicable to the nine legacy agricultural commodities.

II. Proposed referenced contract definition

A. The Commission should avoid imposing unnecessary burdens on market participants in identifying contracts subject to position limits.

(i) The Commission should require exchanges to publish a list of referenced contracts.

We support the Proposed Rule's requirement that exchanges identify whether a new contract they submit under Part 40 meets the definition of a referenced contract. We also commend the Commission's proposed publication of, and regular updates to, a workbook that would provide a non-exhaustive list of referenced contracts.[18] For existing contracts, however, the Proposed Rule does not specify who would be responsible for determining whether a contract qualifies as a referenced contract (other than an economically equivalent swap) that is subject to federal position limits. Instead, the Commission asks whether it should require exchanges to maintain and publish a list of referenced contracts and location basis contracts offered on their platforms.[19]

We strongly urge the Commission to require exchanges to publish a list of referenced contracts (other than economically equivalent swaps) subject to federal position limits. A lack of clarity on whether a contract is appropriately linked to a core referenced futures contract—and thus subject to federal position limits—creates at least three problems. First, left to decide on their

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[17] *See* In the Matter of Limits on Position and Daily Trading in Wheat, Corn, Oats, Barley, Rye, and Flaxseed, for Future Delivery Findings of Fact, Conclusions, and Order, 3 Fed. Reg. 3145 (Dec. 24, 1938) (imposing position limits on six grain products); *see also* Position Limits for Derivatives, 81 Fed. Reg. 96704, 96708 (proposed Dec. 30, 2016) ("In the Commission's experience (including the experience of its predecessor agency), it generally took many months to make a necessity finding with respect to one commodity."), *available at* https://www.cftc.gov/sites/default/files/idc/groups/public/@lrfederalregister/documents/file/2016-29483a.pdf.

[18] *See* Proposed Rule at 11621.

[19] *See* Proposed Rule at 11623 (Request for Comment (16)).

own, individual market participants would incur potentially significant costs in time and effort to ascertain the contract's regulatory status. Second, market participants could inadvertently violate the applicable position limit and potentially face enforcement actions and sanctions by the exchange, the Commission, or both. At the same time, certain bad actors could take on excessive speculative positions by purporting to net them down with offsetting positions in a contract of uncertain status with respect to federal position limits. Third, out of an abundance of caution, certain market participants might simply refrain from trading contracts that could expose them to position limits violations due to ambiguity.

Compared to individual market participants, exchanges are far better positioned to resolve uncertainties in a contract's status under the federal position limits regime. They have the legal, operational and administrative resources to identify, publicize and update efficiently a list of referenced contracts subject to federal position limits—resources that a large number of market participants lack. Even if certain market participants have that capacity, the fruits of their efforts would be limited to those firms and possibly their counterparties, which does not address the market-wide problems that would arise from the uncertainty described above.

(ii) The Commission should adopt the proposed regime of deference to market participants' good faith judgment for identifying economically equivalent swaps.

We support the Commission's proposed approach that market participants can rely on their "reasonable, good faith effort" in determining whether a swap is economically equivalent to a referenced contract and thus subject to federal position limits. We recognize that it would be unrealistic to maintain a list of economically equivalent swaps given that many swaps still are traded over the counter and, as the Commission notes, each determination of whether a swap is economically equivalent to a referenced contract would involve a facts and circumstances analysis.[20] It would also be inefficient and counterproductive to require market participants to obtain the Commission's approval each time they identify an economically equivalent swap.

We also recognize that, as a necessary component of the proposed approach, the Commission would retain the ultimate authority to make an independent determination of whether a swap is economically equivalent to a referenced contract.[21] At the same time, the Commission's post-hoc review of a market participant's determination with respect to economically equivalent swaps should be based only on objective criteria, such as material contractual specifications, terms and conditions of a particular swap. While we understand the proposed "reasonable, good-faith effort" standard to be an objective reasonable person test,[22] we recommend that the Commission provide an explicit safe harbor to provide regulatory certainty to market participants.[23]

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[20] *See* Proposed Rule at 11617.

[21] *See* Proposed Rule at 11617.

[22] *See* Proposed Rule at 11617.

[23] If the Commission decides not to require exchanges to publish a list of referenced contracts as Citadel recommends above, we believe that market participants who rely on their "reasonable, good faith" judgment in identifying referenced contracts should not be deemed to have violated the applicable position limits—similar to the Commission's proposed approach for market participants in identifying economically equivalent swaps.

B. We support the proposed narrow definition of economically equivalent swap.

We agree with the Commission that adopting a narrow definition of economically equivalent swap would best achieve Congress's policy goals in CEA section 4a(a)(2)(C) and (3). As the Commission recognizes, because over-the-counter ("OTC") swaps are bilaterally negotiated and customizable, a broader definition of economically equivalent swap could allow market participants to structure swaps that inappropriately net down positions in other referenced contracts in a way that frustrates the purposes of position limits.[24]

III. The Commission should increase the proposed non-spot month position limit for CBOT KC HRW Wheat.

For the non-spot month, the Commission proposes to maintain the position limit for CBOT KC HRW Wheat ("KW") and MGEX HRS Wheat ("MWE") at the existing level of 12,000 contracts while increasing the limit for CBOT Wheat ("W") from 12,000 to 19,300 contracts. The Commission reasons that a comparable increase for KW and MWE contracts is not warranted because "the non-spot month level appears to be extraordinarily large in comparison to open interest in KW and MWE markets."[25]

We urge the Commission to increase the proposed non-spot month limit for KW contracts. Market data show that since 2016, the total aggregate open interest in KW contracts has been more than three to five times the total aggregate open interest in MWE contracts each year. Moreover, market participants are increasingly relying on KW contracts as a primary hedging tool in global wheat markets. The following table summarizes data points for these markets:

Year	2014	2015	2016	2017	2018	2019	2020
HRW Total Supply (in millions of bushels)	1,092	979	1,126	1,529	1,342	1,245	1,343
HRS Total Supply (in millions of bushels)	671	747	791	770	639	794	806
KW Aggregate Open Interest	158,401	131,572	193,145	238,525	330,483	265,274	215,264
MWE Aggregate Open Interest	68,311	69,343	62,043	67,690	61,893	60,625	70,569

Source: U.S. Department of Agriculture for the HRW and HRS supply data; Bloomberg for the KW and MWE open interest data (a one day snapshot from the last business day of each year listed).

Given the deep liquidity in, and increasing demand for, KW contracts, we believe that a higher limit is warranted for KW contracts.

We note the Commission's concern that breaking the position limit parity for those markets might impose liquidity costs and harm bona fide hedgers in both markets.[26] Market data show, however, that the domestic supply of HRW, the primary crop for KW contracts, is nearly twice the size of the domestic supply of HRS, the primary crop for MWE contracts. It would be

[24] *See* Proposed Rule at 11615-16.

[25] *See* Proposed Rule at 11677.

[26] *See* Proposed Rule at 11677.

unreasonable to continue to insist on non-spot month level parity for the KW and MWE contracts when the data suggest that those markets are not comparable to each other in key respects.

IV. The Commission should increase proposed position limits for natural gas.

The Proposed Rule would allow market participants to hold up to five times the proposed 2,000 contract spot month limit, per exchange, for New York Mercantile Exchange Henry Hub Natural Gas ("NYMEX NG") equivalent-size cash-settled positions net long or net short, as long as the participant holds no spot month positions in the NYMEX NG physically-settled natural gas contracts. Such participant also would be permitted to hold an additional 10,000 contracts in cash-settled natural gas economically equivalent swaps.[27]

We believe the larger limits for the cash-settled contracts are warranted, but should not be conditioned on holding no physically-settled contracts. We agree with the Commission's observation that "cash-settled natural gas contracts serve an important function for hedgers and speculators who wish to recreate and/or hedge the physically-settled NYMEX NG contract price without being required to make or take delivery."[28] We do not agree, however, that the requirement for relying on the conditional exemption—that the market participant hold no position in the physically-settled contract—is necessary to prevent manipulation.[29] The supply of cash-settled contracts is, in principle, unlimited, as the supply is not limited by the amount of a given physical commodity that can be delivered at a given point in time. Given this unlimited supply, the potential circumstances that position limits are intended to address—such as market imbalances and price distortions around the time of delivery—do not manifest themselves in the market for cash-settled contracts.

Rather, conditioning the higher position limits on cash-settled contracts on exiting positions in the physically-settled contract will unnecessarily constrain liquidity in an otherwise important market, with no clear countervailing benefit. While the cash-settled contracts are priced or settled based on a reference to the physically-settled contracts, it is unclear how cash-settled contracts could influence, let alone distort, the price of a physically-settled contract (nor are the two fungible). In addition, the conditionality would impede market participants with a meaningful position in the cash-settled market from participating in the physically-settled market—limiting flexibility and impairing market efficiency.

If the Commission elects not to remove the spot month limit conditionality, at a minimum, revisions are needed to ensure that the proposal does not actually decrease existing limits for cash-settled contracts. Under the Proposed Rule, a market participant may hold up to 2,000 contracts in the spot month for NYMEX NG equivalent-size cash-settled positions net long or net short, if the participant does not rely on the conditional exemption for certain natural gas positions. The Commission describes this proposed limit as an increase from the existing exchange-set spot month limit of 1,000 contracts. In practice, however, the proposed federal limit of 2,000 contracts would appear to decrease the total number of cash-settled NYMEX NG equivalent-size contracts that a market participant may hold in the spot month. Today, assuming that a market participant

[27] *See* Proposed Rule at 11601.

[28] *See* Proposed Rule at 11641.

[29] *See* Proposed Rule at 11641.

holds the maximum number of contracts allowed under exchange-set spot month limits, the participant can hold up to 3,000 contracts—1,000 each at the three exchanges (New York Mercantile Exchange, ICE Futures U.S. and Nodal Exchange) that offer cash-settled natural gas contracts. If the federal limit is set at an aggregate level of 2,000 contracts, however, the participant would be prevented from taking more than 2,000 net long or net short positions overall across the exchanges, which would effectively reduce the current limit by 1,000 contracts, or 33%.

The Commission does not explain why such a decrease in position limits is necessary or appropriate, nor do we know whether such decrease was intended or whether the Commission meant the proposed limit on natural gas cash-settled contracts to apply per exchange (like the conditional spot month limit on natural gas). We urge the Commission to increase the proposed limit for NYMEX NG to a level that, at a minimum, preserves the current level of limits permitted across exchanges (3,000 contracts). Moreover, to the extent that the proposed limits for other commodities would similarly result in a *decrease* from the aggregate of the existing exchange limits, the Commission should also re-consider those proposed limits.

V. Exemptions from federal position limits

A. Spread exemptions

The Proposed Rule would exclude from the otherwise applicable position limit a "spread transaction," which includes a calendar spread. Appendix C to Part 150, in turn, would define a calendar spread to mean "a cash-settled agreement, contract, or transaction that represents the difference between the settlement price in one or a series of contract months of an agreement, contract, or transaction and the settlement price of another contract month or another series of contract months' settlement prices for the same agreement, contract, or transaction." The Commission proposes that exemptions for spread transactions be self-effectuating for purposes of federal limits, provided that (1) the position falls within one of the categories set forth in the proposed "spread transaction" definition, and (2) the market participant separately applies to the applicable exchange for an exemption from exchange-set limits.[30]

We commend the Commission's efforts to clarify the scope of the proposed spread exemptions. We request further clarification, however, regarding the application of the proposed calendar spread exemption for spot month and single month positions. For example, we ask that the Commission clarify that a market participant that holds calendar spread positions of long 2 months out and short 6 months out, or long in the spot month and short 6 months out, for the same legacy agricultural contract (which is subject to a non-spot month federal position limit), can net down the two positions for purposes of the applicable federal spot month or single month limit.[31]

With respect to proposed spread exemption application process, the Commission should mirror the proposed process for non-enumerated bona fide hedge exemptions. As proposed,

[30] *See* Proposed Rule at 11602.

[31] While we oppose the extension of non-spot month limits beyond the legacy agricultural contracts, the clarification we are seeking regarding the general application of the calendar spread exemption should apply to all contracts that currently are, or in the future may become, subject to federal single month limits.

market participants with a spread position that does not fit within the proposed spread transaction definition would need to apply directly to the Commission and also separately to the applicable exchange in order to obtain an exemption for the spread position.[32] In contrast, market participants could apply only to the applicable exchange (and not separately to the Commission) for purposes of claiming an exemption for a non-enumerated bona fide hedge position.[33] The Proposed Rule does not provide any reason for requiring the dual application process only for spread exemptions that would not be self-effectuating, and we believe that market participants should also be permitted to rely on a streamlined exchange-only application process for spread exemptions.

B. Offsetting positions related to the anticipated merchandising of commodities to be stored in leased facilities should be recognized as an enumerated bona fide hedge.

One of the enumerated bona fide hedge exemptions in the Proposed Rule is for hedges of anticipatory merchandising, which would recognize as bona fide hedge positions (subject to certain conditions) those long or short derivatives positions that offset anticipated changes in the value of the underlying commodity that a person anticipates purchasing or selling.[34] We request that the Commission expand this proposed enumerated bona fide hedge exemption to include offsetting positions related to anticipated changes in the value of the underlying commodity to be stored in facilities on lease, and up to the full storage capacity on lease (rather than only the currently utilized level of leased capacity).

Specifically, we believe that the Commission should recognize as a bona fide hedge futures or swaps positions in natural gas offsetting anticipated changes in the value of commodities to be stored in leased storage facilities (or in any structure that can be used to hold or transport natural gas such as pipelines). Such positions would be economically identical to positions under the proposed enumerated bona fide hedge exemption for anticipated merchandising; the only difference would be whether the hedger owns or leases storage capacity for the underlying commodity anticipated to be purchased or sold.[35] We believe leasing versus owning storage capacity is a distinction without a difference, and that the Commission accordingly should similarly recognize an enumerated bona fide hedge exemption for offsetting positions related to the anticipated merchandising of commodities to be stored in leased facilities, subject to the same conditions as the proposed anticipated merchandising exemption.

VI. Additional implementation phase-in period is warranted for economically equivalent swaps.

We generally support the Proposed Rule's 12-month implementation phase-in period. The Proposed Rule, if adopted, would require market participants to make significant adjustments in their operations in response to the new federal position limits regime, including, for example, building or updating compliance and monitoring systems, modelling risks and reviewing and possibly adjusting trading strategies. In this regard, if the Proposed Rule is finalized, we urge the

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[32] *See* Proposed Rule at 11638-39.

[33] *See* Proposed Rule at 11638.

[34] *See* Proposed Rule at 11610-11.

[35] *See* Proposed Rule at 11610-11.

Commission to continue to evaluate during the phase-in period whether further extensions of the compliance date would be necessary for orderly implementation of the new position limits.

In addition, we believe that the Commission should provide a six-month extension of the compliance date for economically equivalent swaps. Most economically equivalent swaps would be OTC swaps that, compared to exchange-listed contracts, warrant special consideration because swaps have never been subject to position limits, whether set by an exchange or the Commission, and the Commission has limited experience in regulating swaps generally. Given that exchanges have no visibility into OTC swaps, the Commission and market participants would bear most of the compliance costs for position limits on swaps—without the benefit of exchanges' decades-long experience in applying and monitoring position limits that would be available for exchange-listed referenced contracts. For example, as the Commission acknowledges, even the initial step of identifying which swap contracts would be deemed economically equivalent to a referenced contract—and therefore subject to federal position limits—would involve a facts and circumstances analysis by each market participant.[36] Market participants would likely encounter many other operational and administrative challenges if the Commission adopts the Proposed Rule to impose position limits on economically equivalent swaps. To mitigate the uncertainties and compliance challenges that market participants would face, we urge the Commission to provide additional implementation time for economically equivalent swaps.

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We appreciate the opportunity to provide comments on the Proposed Rule and urge the Commission to adopt the Proposed Rule along with our recommendations provided in this letter. For the reasons stated above, we believe that our recommendations would help the Commission better achieve the statutory goals of position limits. Please feel free to call the undersigned at (646) 403-8200 with any questions regarding these comments.

Respectfully,

/s/ Stephen John Berger
Managing Director
Global Head of Government & Regulatory Policy

[36] *See* Proposed Rule at 11617.