MANAGED FUNDS ASSOCIATION

sifma asset management group

AIMA

February 28, 2017

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

Christopher Kirkpatrick
Secretary
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:

Managed Funds Association ("**MFA**"), the Asset Management Group of the Securities Industry and Financial Markets Association ("**SIFMA AMG**"), and the Alternative Investment Management Association ("**AIMA**") (collectively, the "**Associations**")[1] appreciate the opportunity to provide comments to the Commodity Futures Trading Commission (the "**Commission**" or "**CFTC**") on its reproposed position limits rulemaking (the "**Reproposal**").[2]

The Associations' members have a keen interest in the Commission's efforts to finalize a prudent position limits regime. They utilize commodity derivatives in their capacity as fiduciaries to private and public funds as well as separately managed accounts for a wide range of investors and retirement savers, and rely on fair, competitive and transparent pricing and liquidity. Investment funds and separately managed account clients play a vital role in these markets by assuming price risk from commercial participants (hedgers) on the long and short sides of the

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[1] MFA represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry's contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns. SIFMA AMG's members represent U.S. asset management firms whose combined global assets under management exceed $34 trillion. The clients of SIFMA AMG member firms include, among others, tens of millions of individual investors, registered investment companies, endowments, public and private pension funds, UCITS and private funds such as hedge funds and private equity funds. AIMA is the trade body for the hedge fund industry globally; AIMA's membership represents all constituencies within the sector – including hedge fund managers, fund of hedge funds managers, prime brokers, fund administrators, accountants and lawyers – and comprises over 1,800 corporate bodies in more than 50 countries.

[2] Position Limits for Derivatives, 81 Fed. Reg. 96,704 (proposed Dec. 30, 2016).

market, and providing the liquidity that facilitates price discovery and risk transfer for businesses around the world. As such, the Associations are concerned that any rule that would prevent the Associations' members from trading on behalf of their clients or unnecessarily or disproportionately increase the costs of compliance would harm the liquidity and price discovery function of the derivatives market.

The consideration of whether, how, and at what levels to impose speculative position limits and *bona-fide* hedge exemptions requires that the Commission carefully balance potentially competing goals set forth in the Commodity Exchange Act (the "**Act**") for setting position limits. These include preventing market manipulation, protecting against excessive speculation, ensuring sufficient market liquidity for hedgers, and deterring disruption to price discovery. The complexity of the task is illustrated by the series of rulemaking notices, withdrawals, and re-proposals that have preceded this re-proposed position limits rulemaking. The first rulemaking notice that the Commission issued was subsequently withdrawn.[3] The Commission issued a second notice, and adopted rules in 2011,[4] but ultimately the D.C. District Court vacated the rules because the court found that section 4a(a)(1) of the Act "clearly and unambiguously requires the Commission to make a finding of necessity prior to imposing position limits".[5] In 2013, the Commission issued a third notice, relating to aggregation of positions, and a fourth notice, relating to reproposed position limits (the "**2013 Proposal**").[6] The Commission then issued a revised reproposal pertaining to aggregation of positions and federal position limits,[7] and adopted final rules on aggregation of positions.[8] Collectively, the Associations have commented on all five of the Commission's proposed rulemakings related to the imposition of federal position limits on physical commodity derivatives issued between 2010 and 2015.[9]

The Associations appreciate that the Commission and its staff continue to refine proposed rulemaking on federal position limits; however, our members continue to have serious concerns with the Commission's proposed position limits framework, including its fundamental underpinnings. Without having made a finding that excessive speculation exists in the markets or

[3]Federal Speculative Position Limits for Referenced Energy Contracts and Associated Regulations, 75 Fed. Reg. 4,144 (proposed Jan. 26, 2010), *withdrawn* 75 Fed. Reg. 50,950 (Aug. 18, 2010).

[4]Position Limits for Derivatives, 76 Fed. Reg. 4,752 (proposed Jan. 26, 2011); Position Limits for Futures and Swaps, 76 Fed. Reg. 71,626 (adopted Nov. 18, 2011); vacated by *Int'l Swaps & Derivatives Ass'n v. U.S. Commodity Futures Trading Comm'n*, 887 F. Supp. 2d 259 (D.D.C. 2012).

[5] *Int'l Swaps & Derivatives Ass'n*, 887 F. Supp. 2d at 269.

[6]Aggregation of Positions, 78 Fed. Reg. 68,946 (proposed Nov. 15, 2013); Position Limits for Derivatives, 78 Fed. Reg. 75,680 (proposed Dec. 12, 2013).

[7] Position Limits for Derivatives and Aggregation of Positions, 80 Fed. Reg. 10,022 (proposed Feb. 25, 2015).

[8] Aggregation of Positions, 81 Fed. Reg. 91,454 (Dec. 16, 2016).

[9] See Appendix A for copies of the Associations' previous comment letters related to the position limits regime and the above-referenced D.C. District Court decision. The Associations incorporate these comment letters into this response to the Reproposal.

that position limits are necessary in each of the core referenced futures contracts, we believe that the Commission's economic basis for justifying its regulatory policy and methodology for implementing position limits remains flawed. The Associations believe that regulatory policy, especially a policy as significant and with such a profound market impact as position limits, should be designed based on sound market and economic principles. Instead, the Commission's proposals use a simplistic one-size-fits-all approach to establish position limit levels based on a generic percentage of deliverable supply and open interest.

For these reasons, as discussed in more detail below, the Associations cannot support the Reproposal in its current form and urge the Commission to reject it and reconsider what, if any, additional regulations are needed to meet its statutory objectives.

Nevertheless, if the Commission determines to move forward with position limits, the Associations request that the Commission narrowly tailor the framework to achieve a specific market outcome, in a way that is designed to be minimally disruptive, practical, and not overly complicated to administer by market participants. The Commission's currently proposed position limits framework, in combination with the final aggregation rules, is so complex that market participants may be unable to trade in the U.S. derivatives markets without extensive cost and regulatory burden. Firms will be required to regularly obtain legal advice on highly nuanced issues and implement a comprehensive position limits compliance protocol with operational components that monitor contracts (both referenced and those deemed "economically equivalent") across affiliated entities and accounts that must be continuously aggregated in real-time. Similarly, the proposed framework will require the Commission to continue to dedicate significant resources to administer regulations. We respectfully urge the Commission to consider a streamlined approach that reduces unnecessary regulatory burdens, facilitates compliance, eliminates uncertainty, and leverages the market and regulatory experience and expertise of exchanges.

I. SUMMARY OF RECOMMENDATIONS

As the Commission considers the Reproposal and public comments, it should examine carefully all relevant data and consider available alternatives in determining whether there are demonstrable concerns over excessive speculation. The Associations request the Commission to:

- Identify a clear standard of "excessive speculation" and incorporate that standard in its required necessity findings.

- Before imposing position limits on a core referenced futures contract,[10] make a necessity finding specific to such core referenced futures contract and explain why position limits, and the levels at which they are fixed, are appropriate for each such contract. These steps should be supported by empirical evidence of the need for the position limits and the levels

[10] In the Reproposal, the Commission defines "core referenced futures contract" to mean "a futures contract that is listed in § 150.2(d)." The table in Proposed Rule 150.2(d) identifies 25 contracts as core referenced futures contracts.

at which position limits are established, including substantive economic, data-based rationale.

- To the extent the Commission makes a necessity finding and determines that position limits are appropriate for a specific core referenced futures contract:

    - Provide individual consideration to the contract's economic characteristics and the market dynamics of the underlying commodity to appropriately tailor position limit levels to the contract. This determination should balance the Act's goals of preventing excessive speculation, ensuring sufficient market liquidity for *bona fide* hedgers, and maintaining the price discovery function of the underlying market.

    - Make an independent finding that limits on other than spot month contracts are needed to prevent excessive speculation.

    - Delegate to exchanges the responsibility and authority to administer position limits and/or position accountability levels (in the case of non-spot months), including setting levels, monitoring for compliance, and granting or rejecting requests for exemptive relief.

    - Exclude economically equivalent contracts from position limits at this time to provide more time for the Commission to obtain and carefully analyze higher quality data regarding the trading, liquidity and other market characteristics of economically equivalent contracts and to resolve interpretational and operational challenges caused by the Reproposal.

    - Modify the proposed conditional spot month limit to permit market participants to hold cash-settled contracts five times the limit of the physical-delivery contract regardless of whether positions are held in the underlying physical-delivery contracts.

    - With respect to exchange-granted, non-enumerated *bona fide* hedging exemptions and the Commission's *de novo* review of such exemptions, provide a market participant with the opportunity to be heard by the Commission or its staff before the Commission takes action to modify or terminate the relevant exchange exemption applicable to such market participant, and provide for a more reasonable and less disruptive liquidation provision should the Commission take such action.

    - Permit a risk management exemption involving swap exposure, including commodity index swaps.

- Revise the final aggregation rule to reduce compliance burdens and operational challenges.

II. THE COMMISSION HAS NOT DEMONSTRATED THE NECESSITY AND APPROPRIATENESS OF THE PROPOSED POSITION LIMITS

A. The Commission Offers No Meaningful Necessity Finding for Each of the 25 Core Referenced Futures Contracts

Section 4a(a)(1) of the Act[11] requires the Commission to make a necessity finding before imposing position limits. In *ISDA v. CFTC*, the D.C. District Court interpreted section 4a(a)(1) of the Act, finding that this section "clearly and unambiguously requires the Commission to make a finding of necessity prior to imposing position limits."[12] The Associations believe that the Commission must make a necessity finding that is specific to each core referenced contract,[13] taking into account the characteristics of each commodity and market dynamics, and weighing the potential adverse impact of limits on each such contract.[14]

The Commission's burden is not discharged by its declaration that it "preliminarily finds it necessary to implement position limits as a prophylactic measure for the 25 core referenced futures contracts".[15] The Commission offers as support for its declaration the Hunt Brothers and Amaranth cases, without additional, more meaningful analysis (other than the inconclusive review of studies, discussed below).[16] Moreover, in the Hunt Brothers and Amaranth cases, volatility arose

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[11] Section 4(a)(1) reads in relevant part: "For the purpose of diminishing, eliminating, or preventing such burden, the Commission shall, from time to time, after due notice and opportunity for hearing, by rule, regulation, or order, proclaim and fix such limits on the amounts of trading which may be done or positions which may be held by any person, including any group or class of traders, under contracts of sale of such commodity for future delivery on or subject to the rules of any contract market or derivatives transaction execution facility, or swaps traded on or subject to the rules of a designated contract market or a swap execution facility, or swaps not traded on or subject to the rules of a designated contract market or a swap execution facility that performs a significant price discovery function with respect to a registered entity, as the Commission finds are necessary to diminish, eliminate, or prevent such burden." 7 U.S.C. § 6a(a)(1).

[12] *Int'l Swaps & Derivatives Ass'n*, 887 F. Supp. 2d at 269. The court also examines section 4a of the Act in its entirety and determines that Congressional intent is not unambiguous and, therefore, proceeds with Step Two of its Chevron analysis. The court states: "The Court expresses no opinion on whether the construction of Section 6a the CFTC now advances is permissible under Chevron Step Two. Although the Court does not foreclose the possibility that the CFTC could, in the exercise of its discretion, determine that it should impose position limits without a finding of necessity and appropriateness, it is not plain and clear that the statute requires this result." *Id.* at 282. In deciding not to remand the rule to the CFTC but, rather, to remand and vacate the rule, the court states: "The agency failed to bring its expertise and experience to bear when interpreting the statute and offered no explanation for how its interpretation comported with the policy objectives of the Act. The Court cannot be sure that the agency will interpret the statute in the same way and arrive at the same conclusion after further review and cannot be sure whether a similar position limits rule will withstand challenge under the APA." *Id.* at 284.

[13] *See, e.g.*, Position Limits for Derivatives, 81 Fed. Reg. 96,708 (proposed Dec. 30, 2016) (describing past instances where the Commission attempted to make a necessity finding for each contract for which it established position limits).

[14] Section 4a(a)(3)(B); 7 U.S.C. § 6a(a)(3)(B).

[15] Position Limits for Derivatives, 81 Fed. Reg. 96,716.

[16] *Id.* at 96,727. When describing studies related to Amaranth and the Hunt Brothers, the Commission admits that "[s]ome of the evidence cited in these studies is anecdotal". *Id.*

primarily in the spot month, and Amaranth was plagued by inadequate risk management. These cases cited by the Commission also do not support a necessity finding for non-spot month limits and only address the silver and natural gas markets where the alleged conduct occurred in 1979-80 (Hunt Brothers) and 2006 (Amaranth).[17] Although the number of economic studies Commission staff has reviewed increased since the 2013 Proposal (from 132 to 244), the Commission reiterates that "[t]here is a demonstrable lack of consensus in the studies."[18] Nonetheless, the Commission has determined to "act on the side of caution"[19] and establish position limits without analyzing each of the 25 core referenced contracts to separately find that position limits are necessary for each such contract.

The requirement to make a necessity finding was not altered or reduced by the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Dodd-Frank Act**"), as illustrated by the D.C. District Court's holding in *ISDA v. CFTC*. Notwithstanding the Court's holding and the Commission's insufficient support for a necessity finding, the Commission continues to contend that a necessity finding is not required because (1) "Congress has made the antecedent judgment on an across-the-board-basis that position limits are necessary for physical commodities"[20] and (2) it would be impossible to make a commodity-by-commodity necessity finding within the 180-day (for exempt commodities) and 270-day (for agricultural commodities) time frames after the Dodd-Frank Act was signed into law for establishing position limits.[21] The Commission's first argument contradicts the D.C. District Court's holding that the Commission must make a necessity finding.

The Commission's second argument that the legislative time frames are too short to make a necessity finding is based on examples from the 1930s where the Commission states that it made necessity findings for six grain contracts in 13 months, for a cotton contract in less than a year, and for soybean and egg contracts in seven months. However, this argument does not consider advances in technology and the Commission's own experience in establishing position limits since that time period that could enable the Commission to make necessity findings for each core referenced contract within the congressionally mandated time frames. The time frames are not pertinent to whether a necessity finding must be made, especially given the number of years that have passed since the Dodd-Frank Act was enacted, and should not restrict the Commission from taking its time to adopt workable rules. The Associations' position is that it is essential that the Commission take the time necessary to gather accurate data and adopt an effective regime that is

[17] The Associations contend that the Commission's declaration of necessity does not sufficiently address the silver and natural gas markets that were the subject of the cited enforcement actions, which arose in markets that have continued to evolve in the intervening decades.

[18] *Id.* at 96,723 (quoting Position Limits for Derivatives, 78 Fed. Reg. at 75,694) (internal citations omitted).

[19] *Id.*

[20] *Id.* at 96,710.

[21] *Id.* at 96,708.

designed to prevent adverse impacts on the markets. Where the Commission cannot make a necessity finding with respect to a contract, it should not adopt a final position limits rule.

B. The Commission Has Not Demonstrated that the Proposed Position Limit Levels Are Appropriate

The Act provides that, to the extent the Commission establishes position limits, it does so "on the amount of positions, *as appropriate*, other than *bona fide* hedge positions, that may be held by any person".[22] The Commission has not demonstrated that the proposed position limits or position limit levels are appropriate but instead makes broad generalizations about speculation without first defining excessive speculation. For example, the Commission acknowledges that not all commodity markets exhibit the same price behavior at the same time but commodity markets are, over time, "all susceptible to similar risks from excessive speculation."[23] But it has not performed a contract-by-contract analysis of the market dynamics particular to each core referenced futures contract, which is what the Associations believe the Act requires.

Although the Commission stresses that the "focus of the reproposed rulemaking is not speculation *per se*" but, rather, excessive speculation, the Commission has not articulated standards to evaluate and determine when "excessive speculation" exists in a market.[24] In establishing position limits to deter "excessive speculation", the Commission should first define "excessive speculation" to explain the appropriateness of the levels at which position limits are established and to clarify the Commission's objective. By articulating such standards, commenters could then provide thoughtful insight into whether position limits and the proposed levels of such limits on each core referenced futures contract are appropriate. The Commission explains that position limits "constrain *only speculators* with excessively large positions in order to diminish, eliminate, or prevent an undue and unnecessary burden on interstate commerce in a commodity."[25] Based on available data, it is not clear whether the proposed position limits regime would restrict only speculators because the Commission's data do not distinguish between speculative traders and hedgers.[26]

Further, the Commission has not determined that position limits are necessary or appropriate outside of the spot month. The Commission's objective to prevent disorderly markets would be better satisfied by focusing efforts in the spot month only. By imposing position limits in the non-spot months, the Commission will adversely affect the markets by causing decreased

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[22] Section 4a(a)(2)(A); 7 U.S.C. § 6a(a)(2)(A) (emphasis added).

[23] Position Limits for Derivatives, 81 Fed. Reg. at 96,727.

[24] *Id.* at 96,718.

[25] I*d.* at 96,720 (emphasis added).

[26] *Id.* at 96,719, n. 176 ("the Commission does not now collect reliable data distinguishing hedgers from speculators").

liquidity and ineffective price discovery, and could push speculators into the cash markets.[27] This is especially true in the further-dated months where there are low levels of liquidity. One end-user has publicly stated that low liquidity appears to be caused by "excessive hedging" that could be solved by increasing the number of speculators to increase liquidity the further out the curve.[28] Similarly, another market participant has described short hedgers and long investors as providing liquidity for each other in the futures markets, serving their interests "in an open, transparent and efficient manner".[29] Liquidity is essential to enable hedgers and speculators to achieve their objectives at efficient prices.[30] Exchange experience demonstrates that certain markets may suffer from insufficient speculation rather than excessive speculation,[31] reinforcing the point that position limits are not necessary in such markets.

Imposing position limits in the non-spot months may have the undesirable effect of raising costs for hedgers by impeding the ability of investment managers to take the other side of such "producer/merchant" positions. Non-spot month position limits may impact the ability of investment managers from taking the other side of producer/merchant positions by further increasing compliance costs or forcing investment managers to choose between contracts/positions closer to the spot month and contracts/positions in further-dated months. Finally, non-spot month position limits may also have the undesirable effect of magnifying the loss of liquidity available to hedgers due to the combination of these limits and consolidation in the investment management industry.[32] Therefore, we again encourage the Commission to avoid any approach that involves the imposition of non-spot month limits, particularly in the absence of evidence or data suggesting that such limits would serve a beneficial purpose. The Associations recommend that the Commission explicitly define excessive speculation to clarify its objectives and to allow market participants an opportunity to more meaningfully comment on whether position limits are

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[27] One study found that "additional regulation of the activities of investors is probably unnecessary and…could have adverse consequences for liquidity and market depth, and worse, may force speculators into the cash markets", corroborating studies from 2011 and 2013. Brooks, Prokopczuk, and Wu, *Boom and Bust in Commodity Markets: Bubbles or Fundamentals?* (Jan. 30, 2014).

[28] Testimony of Lael Campbell, Director, Governmental and Regulatory Affairs and Public Policy, Exelon, Before the CFTC's EEMAC Meeting 83 (Feb. 26, 2015).

[29] Testimony of Kevin Norrish, Managing Director of Commodities Research, Barclays Capital, Prepared Statement Before the CFTC 4 (Mar. 25, 2010), http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/metalmarkets032510_norrish.pdf.

[30] *Id.*

[31] Testimony of Erik Haas, Director of Market Regulation, ICE Futures U.S., Before the CFTC's EEMAC Meeting 82 (Feb. 26, 2015) ("**Haas Testimony**") (stating that ICE Futures U.S. often receives complaints that markets are too wide out the curve and that "there is not enough participation"); Testimony of Lael Campbell, Director, Governmental and Regulatory Affairs and Public Policy, Exelon, Before the CFTC's EEMAC Meeting 83 (Feb. 26, 2015) (stating "it sounds to me like we may have an excessive hedging problem.").

[32] In recent years, investment management firms have consolidated in order to manage rising overhead and compliance costs, and to realize lower fees for investors through the benefits of scale.

necessary and whether position limits and the levels of such limits are appropriate to achieve these objectives.

III. POSITION LIMITS, IF DETERMINED NECESSARY AND APPROPRIATE, SHOULD BE BASED ON COMMODITY CONTRACT CHARACTERISTICS

If the Commission makes a necessity finding for a core referenced futures contract and determines that position limits are appropriate, the Commission should establish position limit levels for such contract that balance factors enumerated in the Act that, at times, compete with one another. When setting limits, the Act instructs the Commission to do so in a way (1) that diminishes, eliminates, or prevents excessive speculation, and deters and prevents market manipulation, squeezes, and corners, (2) but that also ensures sufficient market liquidity for *bona fide* hedgers while not disrupting the price discovery function of the underlying market.[33] To properly calibrate position limits, these factors must be analyzed on a commodity-by-commodity basis. Yet, the Commission has not performed this analysis.

Instead, the Commission proposes to set position limit levels using the same methodology across all 25 referenced contracts and economically equivalent contracts, without appropriately balancing the desire to eliminate excessive speculation with the goals of ensuring sufficient market liquidity and maintaining the price discovery function of the underlying market. Setting spot month limits based on 25% of estimated deliverable supply and all other months based on 10% of open interest for the first 25,000 contracts (and 2.5% on all open interest in excess of 25,000 contracts) for all contracts fails to recognize the differences among commodities, including differences in liquidity, seasonality, and other economic factors. Such a generic, one-size-fits-all approach is not principled or based on economic analysis, and stands in stark contrast with the Commission's articulated approach to the establishment of position limit levels in its prior rulemakings.[34]The Commission should permit exchanges to establish position limits or accountability levels using an appropriate methodology based on their market expertise as opposed to the application of the same, generic methodology to all core referenced futures contracts, whose underlying commodities possess very different characteristics.

Although the Associations believe that position limits are not necessary or appropriate in non-spot months, the Commission should balance the factors enumerated in the Act if it proceeds with requiring position limits in the non-spot months. The Associations request that the Commission approach non-spot month limits in a way that does not inhibit speculators from

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[33] Section 4a(a)(3) of the Act; 7 U.S.C. § 6a(a)(3).

[34] *See, e.g.*, Revision of Federal Speculative Position Limits, 52 Fed. Reg. 38,914, 38,917 (adopted Oct. 20, 1987) ("basing speculative position limits upon the characteristics of a specific contract market is consistent with the practice under Commission Rule 1.61" (adopted in 1981, 46 Fed. Reg. 50,938)); Revision of Federal Speculative Position Limits, 57 Fed. Reg. 12,766, 12,770 (proposed Apr. 13, 1992) ("The fundamental tenet in the Commission's setting of speculative position limits is that such limits must be 'based upon the individual characteristics of a specific contract market'") (citing Revision of Federal Speculative Position Limits, 52 Fed. Reg. 6,812, 6,815 (proposed Mar. 5, 1987)).

trading in non-spot months. As we explain in Section II.B, markets in these months may suffer from insufficient speculation rather than excessive speculation.[35] After balancing the goals of maintaining liquidity and price discovery in non-spot months with the desire to prevent excessive speculation and market manipulation, the Commission may determine that position limits are not necessary or appropriate outside the spot month. The Associations believe that if the Commission establishes a position limits regime in the non-spot month, it should, at most, establish position accountability levels outside the spot month.

If a commodity market has consistently liquid cash markets, abundant storage capacity, and stable levels of supply and demand, it is less likely to be subject to a short squeeze and less susceptible to cornering, even with position limits set at higher than 25% of estimated deliverable supply.[36] For example, the Commission should calculate deliverable supply differently for energy markets than for other commodity classes by considering energy products that are in a different location but that can serve demand in certain areas through the transportation of the products. Thus, estimated deliverable supply should be based on pipeline capacity for natural gas and transmission for power as opposed to load or generation at a certain area.[37] These are just some examples illustrating the need for a commodity-by-commodity analysis using the factors articulated in Section 4a(a)(3) of the Act, rather than the proposed one-size-fits-all approach. The Associations ask that the Commission take an analytical approach to position limits based on the market characteristics of each commodity market or permit exchanges to establish limits.

IV. THE COMMISSION SHOULD ADOPT A PRINCIPLED APPROACH TO POSITION LIMITS

Regulation—as well as the Commission's responses to market participants' concerns about position limits[38]—should be based on economic principles and robust research and analysis. For example, the U.S. Department of Justice ("**DOJ**") and U.S. Federal Trade Commission ("**FTC**") often calculate the Herfindahl-Hirschman Index ("**HHI**") for measuring market concentration in the context of evaluations of mergers. The HHI is calculated by summing the squares of each individual firm's market shares, and thus gives proportionately greater weight to the larger market shares. For example, a market consisting of four firms with market shares of thirty percent, thirty percent, twenty percent, and twenty percent has an HHI of 2600 ($30^2 + 30^2 + 20^2 + 20^2 = 2600$). The HHI ranges from 10,000 (in the case of a pure monopoly) to a number approaching zero (in the case of an atomistic market). Based on their experience, the DOJ and FTC generally classify

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[35] Haas testimony at 82.

[36] *See* 17 C.F.R. § 1.61(a)(2).

[37] Haas Testimony at 100.

[38] For example, commenters expressed concerns that non-spot month limits will deter speculation that does not pose risks of manipulation or price volatility. The Commission's response is that concerns over non-spot month limits are no longer prevalent because position limits have been set at higher levels. *See, e.g.*, Position Limits for Derivatives, 81 Fed. Reg. at 96,722, 884, 857.

markets into three types: Unconcentrated Markets: HHI below 1500; Moderately Concentrated Markets: HHI between 1500 and 2500; Highly Concentrated Markets: HHI above 2500.[39] While the Associations are not suggesting that the Commission adopt the HHI as the basis for establishing excessive speculation or position limit levels, we note that the HHI methodology, while it is applied generally, does take into account particular market composition and dynamics, and is in the form of guidance rather than a rigid rule. The Associations suggest that the Commission take a similar market- and data-based analytical approach rather than just applying an across the board 25% of estimated deliverable supply or 10% of open interest threshold to all contracts without distinction and without the flexibility to adjust for the unique attributes of various markets.

A principled approach to position limits will enhance the Commission's ability to effectively "diminish, eliminate, or prevent" the burden caused by "sudden or unreasonable fluctuations or unwarranted changes in the price of [a] commodity".[40] Such fluctuations or unwarranted changes rarely occur outside of the spot month, but the Commission continues to impose non-spot month limits in the proposed regime. By purporting to set limits at "high" levels, the Commission adopts a regulatory policy not supported by economic research. Moreover, the Commission itself admits to the poor quality of the data it used to establish the position limits in the Reproposal, calling into question the Commission's statements that position limit levels have been established at "high" levels.

In response to a commenter that voiced a concern that "improperly calibrated nonspot month limits would also deter speculative activity that triggers no risk of manipulation", the Commission states that it "sees little merit in this objection because the Reproposal would calibrate the levels of the non-spot month limits to accommodate speculative activity that provides liquidity for hedgers."[41] The Commission explains that position limits are set high and, therefore, the concern that position limits will deter lawful speculative trading should no longer be a concern. Instead, the Commission should have explained the analysis and method it used to calibrate position limits to avoid deterring lawful speculation or adversely impacting liquidity. The Commission's approach, reflected in its repeated comment that the limits are "set high" enough, could adversely affect markets in the future by failing to properly analyze legitimate market concerns over whether position limits are, or could become in the future, improperly calibrated in a way that deters speculative trading and negatively impacts commodity markets.

In any event, no one—including the Commission—really knows whether position limits have been set "high" because current position limits apply only to futures whereas the Commission's proposal, if adopted, would cover futures and economically related over-the-counter ("**OTC**") instruments. The Commission used part 20 swaps data and data on open interest

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[39] Horizontal Merger Guidelines, U.S. Department of Justice and the Federal Trade Commission 18 (Aug. 19, 2010).

[40] *See, e.g.*, Section 4a(a)(1) of the Act; 7 U.S.C. § 6a(a)(1).

[41] *Id.* at 96,722.

in physical commodity futures and options from exchanges to establish position limit levels, noting that it "has determined that it is not yet practicable to use data from swap data repositories" to establish position limits.[42] Thus, it remains unclear whether the Commission's data appropriately considered swaps and all other economically equivalent instruments.[43]

Additionally, the Commission explicitly describes the integrity of the data that it did use as low quality and riddled with errors[44] and states that it "continues to be concerned about the quality of data submitted in large trader reports pursuant to part 20 of the Commission's regulations".[45] Yet, the Commission has established position limits using data from these reports. With respect to part 20 data, the Commission provides that it observed both under- and over-reporting by market participants.[46] Commission staff edited *over 90%* of the available records in some commodities and describes common, *known* errors that it found and edited in the data.[47] The Commission explains that in choosing the approach where it has used data with known errors, it "chooses to repropose higher non-spot month limit levels."[48]

Swap data analyzed by the Commission does not appear to have improved in quality over the past several years based on the Commission's descriptions of such data. For example, Commission staff deleted all swap position data reports submitted by one swap dealer from its analysis because "the reports were inexplicably anomalous in light of other available information, reasonable assumptions and Commission expertise".[49] In describing errors related to swaps, the Commission explains that market participants may have reported swaps that do not satisfy the definition of "referenced contract" (such as trade options), resulting in higher open interest and, therefore, higher limits.[50] By again citing to "high" limit levels, the Commission attempts to resolve deficiencies in its data and conceptual approach that should be resolved with higher quality data and in-depth analysis.

Even where limits are set at a level a market participant is unlikely to breach, poor public policy and "high" position levels do not mitigate the administrative complexity associated with monitoring and aggregating core referenced futures contracts and economically equivalent

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[42] *Id.* at 96,755, n. 507.

[43] *Id.* at 96,722.

[44] *See id.* at 96,755-59.

[45] *Id.* at 96,759.

[46] *Id.*

[47] *Id.* at 96,757. In addition, Commission staff "adjusted the average daily open interest for positions resulting from inter-affiliate transactions and duplicative reporting of positions due to transactions between reporting entities." *Id.* at 96,757.

[48] *Id.* at 96,755, n. 513.

[49] *Id.* at 96,756.

[50] Position Limits for Derivatives, 81 Fed. Reg. at 96,755, n. 514.

contracts. Similarly, Commission staff will continue to expend resources to analyze aggregation exemption notice filings and hedge exemptions even where levels are set "high". The Associations recommend that the Commission prioritize its efforts on obtaining high-quality data from market participants rather than imposing position limits until it can do so based on reliable data regarding futures, swaps and OTC contracts.

V. EXCHANGES SHOULD ADMINISTER THE POSITION LIMITS REGIME

To the extent that the Commission makes a necessity finding for a core referenced futures contract, the Commission should allow exchanges to impose and administer position limits in the spot month and position accountability levels in non-spot months. Exchanges should be delegated the responsibility and authority to administer position limits, including setting levels, monitoring for compliance, and granting or rejecting requests for exemptive relief. In taking this approach, the Commission can reallocate its resources to other regulatory priorities, such as data quality.

Traditionally, the Commission has adhered to the principle that exchanges have exceptional knowledge of individual contract markets to enable them to implement position limits and exemptions "most appropriate" for individual markets.[51] The Associations recommend that the Commission discontinue its duplicative and burdensome efforts in the area of position limits. At a minimum, if the Commission were to insist on itself administering spot month limits, the Commission should permit exchanges to administer non-spot month accountability levels and hedge exemption requests.

The Commission should permit exchanges to establish position limits or accountability levels using an appropriate methodology based on their market experience as opposed to applying the same generic limit methodology to all core referenced futures contracts, whose underlying commodities possess very different characteristics. Accountability levels have been used by exchanges for years to identify and understand large positions, and this regulatory tool allows exchanges to carry out responsible market surveillance without impacting liquidity or unduly limiting beneficial risk management activities of market participants. In addition, position accountability levels for non-spot month contracts will provide greater flexibility to market participants and regulators and will reduce the costs of compliance with hard position limits in non-spot month contracts. Futures exchanges impose position accountability levels because they maintain the market's integrity by providing necessary oversight of market participants while ensuring sufficient liquidity to allow traders to enter or exit the market, without being overly burdensome to traders who, at times, may hold large positions. Position accountability levels are similar to position limits in that a trader who reaches the position accountability level will be exposed to increased exchange scrutiny of the trader's positions. Unlike position limits, position

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[51] *See, e.g.*, Establishment of Speculative Position Limits, 46 Fed. Reg. 50,938, 50,940 (adopted Oct. 16, 1981) (finalizing rules directing exchanges to "employ their knowledge of their individual contract markets to propose the position limits they believe most appropriate").

accountability levels do not prohibit a trader from reaching or exceeding the level. Instead, once a trader hits or exceeds a position accountability level, an exchange may take certain actions, including preventing the trader from increasing the position or requiring the trader to reduce the position and/or requiring the trader to provide the exchange with information about its trading strategy or intentions.[52] Exchanges value the flexibility provided by position accountability levels because they can make educated determinations as to whether a trader's positions could become problematic.

VI. ECONOMICALLY EQUIVALENT CONTRACTS SHOULD NOT BE INCLUDED IN THE POSITION LIMITS REGIME UNTIL DATA QUALITY IMPROVES AND FURTHER ANALYSIS IS COMPLETED

The inclusion of economically equivalent contracts in the position limits regime—despite the Commission being unable to use data from swap data repositories[53]—poses interpretation and operational challenges that could cause inadvertent violations of position limits. A market participant is faced with operational challenges with respect to the necessary monitoring of contracts subject to position limits, not only because of the position aggregation rules, but also because traders would be required to include economically equivalent contracts in their position limits calculations. Tracking bilateral swaps in real-time is onerous and, especially where futures contracts and swaps are booked in different systems, impractical.

In some cases, it may not be clear whether the Commission would consider a swap "economically equivalent" to one of the 25 reference contracts. A market participant would need to seek legal advice on the proper interpretation of this term and implement methods for including swaps that fall within the scope of "economically equivalent" in the market participant's position limits compliance program. Although the Commission has provided a workbook on position limits,[54] the workbook does little to provide guidance on how a market participant should analyze swaps to determine whether a particular swap is economically equivalent to a core referenced contract.

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[52] CME Rule 560 (stating in part: "A person who holds or controls aggregate positions in excess of specified position accountability levels or in excess of position limits pursuant to an approved exemption shall be deemed to have consented, when so ordered by the Market Regulation Department, not to further increase the positions, to comply with any prospective limit which exceeds the size of the position owned or controlled, or to reduce any open position which exceeds position accountability or position limit levels."); ICE Futures U.S. Rule 6.13 (providing the exchange with the authority to "instruct each such Clearing Member to reduce the positions in such accounts twenty-four (24) hours after receipt of the notice, proportionately or otherwise so that the aggregate positions of such accounts at all such Clearing Members does not exceed the position limits and position accountability levels established by this Chapter").

[53] Position Limits for Derivatives, 81 Fed. Reg. at 96,755.

[54] *CFTC Staff Workbook of Commodity Derivative Contracts Under the Reproposal Regarding Position Limits for Derivatives*, http://www.cftc.gov/idc/groups/public/@swaps/documents/file/ poslimitsworkbook120516a.pdf.

The Associations are concerned that if the position limits regime includes economically equivalent contracts, the position limits levels would apply to core referenced futures contracts as well as the economically equivalent contracts rather than just the core referenced futures contract as was the case previously. As a result, position limit levels would be lower than what they should be after taking into account economically equivalent positions that now must be counted toward such position limit levels. Thus, position limit levels may not be as "high" as the Commission contends by including economically equivalent contracts in position limits.[55] The scope of the position limits regime should not include economically equivalent contracts until the Commission has more reliable data and can ensure that limits that include economically equivalent contracts are appropriate. By deferring the inclusion of economically equivalent contracts in the position limits regime, the Commission would allow more time to market participants to analyze their portfolio of contracts and the impact of position limits if they were to include economically equivalent contracts in the position limits calculation. The Commission would also have more time to provide guidance and greater certainty on the types of swaps that are economically equivalent.

VII. ADDITIONAL COMMENTS

A. The Commission's Conditional Spot Month Limit for Natural Gas Should Be Revised to Use a Formula that Will Not Increase Volatility

The Commission revised the proposed conditional spot month limit, making it applicable only to natural gas cash-settled referenced contracts, provided that positions do not exceed 10,000 contracts and the person holding or controlling such positions does not hold or control positions in spot-month physical-delivery referenced contracts. The conditional spot month limit may have adverse consequences, including causing an increase in volatility on the last trading day and hurting liquidity in the physical market. The Associations respectfully request that the Commission adopt an alternate proposal, originally introduced in the 2013 Proposal, where the Commission considered "[s]etting an expanded spot-month limit for cash-settled contracts at five times the level of the limit for the physical-delivery core referenced futures contract, regardless of positions in the underlying physical-delivery contract."[56] The Commission itself recognized that "this alternative would give more weight to protecting liquidity for *bona fide* hedgers in the physical-delivery contract in the spot month".[57]

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[55] In 1987, the Commission determined not to cumulate positions in contracts with identical terms and conditions based on comments that "the proposal would adjust downward their combined current speculative position limits in the spot months". Revision of Federal Speculative Position Limits, 52 Fed. Reg. 38,914, 38,917 (adopted Oct. 20, 1987).

[56] *See, e.g.*, Position Limits for Derivatives, 78 Fed. Reg. 75,680, 75,736-38 (proposed Dec. 12, 2013).

[57] *Id.* at 75,738 (the Commission also notes that this alternative may give "less weight to protecting the price discovery function of the underlying physical-delivery contract in the spot month."). The Associations believe that the alternate approach will protect the price discovery function more than the current conditional spot month limit proposal.

The Associations support this approach because of the concern that the revised proposed conditional spot month limit would unnecessarily constrain funds in their day-to-day trading. For example, for a fund with multiple trading strategies, some of which use physically-delivered contracts and others use cash-settled contracts in the same commodity, the proposed rule's prohibition on holding any positions in the physical-delivery contract would severely constrain the fund's trading strategies. Thus, this type of fund would be blocked from one market altogether and unnecessarily constrained. Another concern is that the revised proposed conditional spot month limit may incentivize some traders to trade only in the cash-settled contract, adversely affecting price discovery and liquidity in the physical-delivery contract. Under the alternate approach considered in the 2013 Proposal, this concern is mitigated. The Commission should strive to promote price discovery and market participation. The Reproposal's rule has the opposite effect. The Associations' approach, suggested by the Commission in the 2013 Proposal, would allow traders to implement multiple trading strategies without blocking them from certain markets or unnecessarily constraining their trading strategies. Therefore, the Associations recommend that the Commission adopt a conditional spot month limit for cash-settled contracts that is set at five times the level of the limit for the physical-delivery core referenced futures contract regardless of positions in the underlying physical-delivery contract.

B. Clarification of Commission Review of Exchange Exemptions from Position Limits is Needed, and *De Novo* Review Should Not Result in Liquidation of a Market Participant's Positions

The Reproposal would permit exchanges to grant non-enumerated exemptions from position limits.[58] The Associations support this provision and suggest improvements to clarify when a Commission review could occur and the standards for such review. In addition, the Associations recommend that the Commission ease the overly prescriptive application requirements for an exchange exemption and clarify *de novo* review standards. Under the proposed regime, the Commission would be permitted to perform a *de novo* review of exchange-granted exemptions.[59] Without clear standards, a *de novo* review presents unnecessary uncertainty and raises practical issues over how to liquidate positions if the Commission disagrees with an exchange exemption. The Commission should abide by an objective standard before it conducts a *de novo* review, and an exchange determination should be presumed correct absent underlying data that reasonably supports the exemption having been granted. Even with an objective standard, the Commission's *de novo* review provision should include an opportunity for the market

[58] Proposed Rule 150.9.

[59] Proposed Rule 150.9(d)(1) ("The Commission may ***in its discretion at any time*** review any non-enumerated *bona fide* hedging position application submitted to a designated contract market or swap execution facility, and all records required to be kept by such designated contract market or swap execution facility pursuant to paragraph (b) of this section in connection with such application, ***for any purpose***, including to evaluate whether the disposition of the application is consistent with section 4a(c) of the Act and the general definition of *bona fide* hedging position in § 150.1.") (emphasis added).

participant to be heard (i.e., due process and a hearing) before the Commission makes a determination to terminate an exchange-granted exemption.

Further, the Associations recommend that, rather than automatically ordering liquidation after the Commission determines that an exchange exemption is not appropriate, the Commission should instead instruct the exchange prospectively not to renew the exemption. A forward-looking approach would alleviate practical challenges and prevents market disruptions associated with forced liquidation. Market participants need, and are entitled, to rely with certainty on relief provided by exchanges. If, however, the Commission chooses to apply its determination on a retroactive basis and retain the forced liquidation provision, traders should be provided with a commercially reasonable period of time to liquidate such positions. We note that the Commission describes a commercially reasonable period of time to liquidate as "less than one business day".[60] A less-than-one-business-day time frame is not a commercially reasonable period for a market participant to perform an orderly liquidation, could result in economic hardship, and could potentially disrupt trading in the market in which such an abrupt liquidation is required because it may not be realistically possible to "orderly" liquidate in less than one business day.

C. Commodity Index Contracts Should Be Excluded From Position Limits and Be a Permissible Risk Management Exemption

Association members continue to support the exclusion of "commodity index contracts" from the proposed definition of "referenced contract." We agree with the Commission's rationale for this exclusion. Commodity index contracts do not "involve a separate and distinct exposure to the price of a referenced [] contract's commodity" price.[61] The exclusion of commodity index contracts from position limits benefits many asset managers and their customers who invest in such products in order to gain price exposure to a diversified array of commodities over a diverse set of maturities. The liquidity added to commodity markets by these investments is particularly beneficial in longer dated maturities where liquidity can be scarce. Commercial, *bona fide* hedgers that might use long-dated commodity derivatives can more cost-effectively establish long-term hedges because of the liquidity that commodity index contracts provide.

The Commission explicitly prohibits exchanges from recognizing a non-enumerated *bona fide* hedging position where such non-enumerated *bona fide* hedging position involves a commodity index contract.[62] Such a prohibition represents a significant deviation from current practice. Counterparties to commodity index swaps currently can remain in compliance with position limits rules if they exceed a position limit based on a position that hedges OTC swap

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[60] Position Limits for Derivatives, 81 Fed. Reg. at 96,826, n.1099.

[61] Federal Speculative Position Limits for Referenced Energy Contracts and Associated Regulations, 75 Fed. Reg. 4,144, 4,153 (Jan. 26, 2010).

[62] Proposed Rules 150.9(a)(v); 150.10(a)(iv).

exposure, including commodity index swap price risk under the rules of a designated contract market.

The Associations respectfully request the Commission to reconsider the prohibition on a risk management exemption involving swap exposure. The failure to do so will have the effect of reducing liquidity and causing worse pricing for swaps, including commodity index swaps. Such effects were displayed in the commodity index swaps markets leading up to the effective date of the Commission's vacated part 151 position limits rules (rules that did not provide for an exemption for positions offsetting commodity index contract price risk). During this time period, the Associations' members were forced to consider trading with less creditworthy counterparties to source liquidity because their regular counterparties were concerned about violating the position limits rules.

D. The Commission Should Revise the Aggregation Rule to Resolve Practical Challenges

The rules governing aggregation prior to the February 14, 2017 effective date of the final aggregation rule published late last year[63] were used effectively for decades to comply with existing agricultural commodity position limits. The final aggregation rules present a number of operational and interpretive challenges, which had been raised by the Associations but not addressed in the final rule. We would strongly urge the Commission to revisit the recent changes to the aggregation rule and reconsider its approach.

VIII. CONCLUSION

The Associations do not support a position limits regime that is not based on a finding of necessity, where limits are established based on incomplete or inaccurate data and generic formulas rather than substantive economic analysis of applicable market dynamics.

The Associations believe that the Commission needs to clearly articulate its interpretation of "excessive speculation" and apply position limits only to those contracts for which it makes a specific necessity finding and determination of the appropriateness of the limits for each such contract. While we believe that such an assessment should lead the Commission to reject the Reproposal, should the Commission proceed, the Associations recommend that the Commission:

- Make its finding specific to such core referenced futures contract and give consideration to a commodity contract's economic characteristics to appropriately tailor position limits to the contract;

[63] Aggregation of Positions, 81 Fed. Reg. 91,454 (Dec. 16, 2016).

- Make an independent finding that limits on other than spot month are needed to prevent excessive speculation;
- Delegate to exchanges the responsibility and authority to administer position limits, including setting levels, monitoring for compliance, and granting or rejecting requests for exemptive relief;
- Exclude economically equivalent contracts from position limits at this time;
- Allow market participants to hold cash-settled contracts five times the limit of the physical-delivery contract regardless of positions in the underlying physical-delivery contracts;
- Eliminate the forced liquidation provision and provide a market participant with the opportunity to be heard before the Commission terminates an exchange-granted non-enumerated *bona fide* hedge exemption;
- Permit a risk management exemption involving swap exposure, including commodity index swaps; and
- Revise the final aggregation rule to reduce compliance burden and operational challenges.

We appreciate the opportunity to offer comments to the Reproposal. We would be happy to discuss our comments or any of the issues raised by the Commission's position limits proposal at greater length with the Commission or its staff. If the staff has any questions, please do not hesitate to call Jennifer Han of MFA at 202.730.2943, Laura Martin of SIFMA AMG at 212.313.1176, or Adam Jacobs-Dean of AIMA at 44 20 7822 8380.

Respectfully Submitted,

/s/ Stuart J. Kaswell
Stuart J. Kaswell
Executive Vice President & Managing Director, General Counsel
Managed Funds Association

/s/ **Jiří Król**
Jiří Król
Deputy CEO, Head of Government and Regulatory Affairs Alternative Investment Management Association

/s/ **Laura Martin**
Laura Martin
Managing Director and Associate General Counsel
SIFMA's Asset Management Group

cc:

The Honorable Acting Chairman J. Christopher Giancarlo
The Honorable Commissioner Sharon Bowen

APPENDIX A

The Associations' Prior Comments Regarding
CFTC Proposed Rules on Position Limits and the Related Court Decision

A. Proposed Rule on Federal Speculative Position Limits for Referenced Energy Contracts and Associated Regulations (75 FR 4144; open, Jan. 26, 2010)

1. Letter from Richard H. Baker, President and CEO, Managed Funds Association, to David A. Stawick, Secretary, Commodity Futures Trading Commission (Apr. 26, 2010), *available at:* http://www.managedfunds.org/downloads/MFA%20CFTC%20energy%20spec%20limits.4.26.10.pdf

B. Proposed Rule on Position Limits for Derivatives (76 FR 4752; open, Jan. 26, 2011)

1. Letter from Richard H. Baker, President and CEO, Managed Funds Association, to David A. Stawick, Secretary, Commodity Futures Trading Commission (Mar. 28, 2011), *available at:* http://www.managedfunds.org/wp-content/uploads/2011/06/3.28.11-MFA_Position_Limits_final.3.28.pdf

2. Letter from Jiří Król, Director of Government & Regulatory Affairs, Alternative Investment Management Association, to David A. Stawick, Secretary, Commodity Futures Trading Commission (Mar. 28, 2011), *available at:* https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=33565

3. Letter from Timothy W. Cameron, Esq., Managing Director, Asset Management Group, Securities Industry and Financial Markets Association, to David A. Stawick, Secretary, Commodity Futures Trading Commission (June 20, 2011), *available at:* http://www.sifma.org/comment-letters/2011/sifma-amg-submits-supplemental-comments-to-the-cftc-on-proposed-position-limits-for-derivatives/

C. Interim Final Rule on Position Limits for Futures and Swaps (76 FR 71626; open, Nov. 18, 2011)

1. Letter from Jiří Król, Director of Government & Regulatory Affairs, Alternative Investment Management Association, to David A. Stawick, Secretary, Commodity Futures Trading Commission (Jan. 17, 2012), *available at:* https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=50064

D. *Int'l Swaps & Derivatives Ass'n v. United States CFTC*, 887 F. Supp. 2d 259 (D.D.C. 2012), https://ecf.dcd.uscourts.gov/cgi-bin/show_public_doc?2011cv2146-69

E. Comments on Proposed Rule for Aggregation, Position Limits for Futures and Swaps (77 FR 31767; open, May 30, 2012)

1. Letter from Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, Managed Funds Association, to David A. Stawick, Secretary,

Commodity Futures Trading Commission (June 28, 2012), *available at:* https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=58278

2. Letter from Jiří Król, Director of Government & Regulatory Affairs, Alternative Investment Management Association, to David A. Stawick, Secretary, Commodity Futures Trading Commission (July 6, 2012), *available at:* https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=58303

F. Comments on Proposed Rule for Aggregation of Positions (78 FR 68946; open, Nov. 15, 2013)

1. Letter from Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, Managed Funds Association, to Melissa D. Jurgens, Secretary, Commodity Futures Trading Commission (Feb. 7, 2014), *available at:* https://www.managedfunds.org/wp-content/uploads/2014/02/MFA-Aggregation-Limits-final-2-7-14.pdf

2. Letter from Jiří Król, Deputy Chief Executive Officer, Head of Government & Regulatory Affairs, Alternative Investment Management Association, to Melissa D. Jurgens, Secretary, Commodity Futures Trading Commission (Feb. 10, 2014), *available at:* https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=59619

3. Letter from Timothy W. Cameron, Esq., Managing Director, Asset Management Group, Securities Industry and Financial Markets Association, Matthew J. Nevins, Esq., Managing Director and Associate General Counsel, Asset Management Group, Securities Industry and Financial Markets Association, and Robert Pickel, Chief Executive Officer, International Swaps and Derivatives Association, to Melissa Jurgens, Secretary, Commodity Futures Trading Commission (Dec. 20, 2013), *available at:* http://www.sifma.org/comment-letters/2013/sifma-amg-and-isda-submit-comments-to-the-cftc-on-aggregation-of-positions/

4. Letter from Timothy W. Cameron, Esq., Managing Director, Asset Management Group, Securities Industry and Financial Markets Association, and Matthew J. Nevins, Esq., Managing Director and Associate General Counsel, Asset Management Group, Securities Industry and Financial Markets Association, to Melissa Jurgens, Secretary, Commodity Futures Trading Commission (Feb. 10, 2014), *available at:* http://www.sifma.org/comment-letters/2014/sifma-amg-submits-comments-to-the-cftc-on-the-aggregation-of-position-limits/

G. Proposed Rule for Position Limits for Derivatives (78 FR 75680; open, Dec. 12, 2013)

1. Letter from Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, Managed Funds Association, to Melissa D. Jurgens, Secretary, Commodity Futures Trading Commission (Feb. 9, 2014), *available at:*

https://www.managedfunds.org/wp-content/uploads/2014/02/MFA-Position-Limits-final-2-9-14.pdf

2. Letter from Jiří Król, Deputy Chief Executive Officer, Head of Government & Regulatory Affairs, Alternative Investment Management Association, to Melissa D. Jurgens, Secretary, Commodity Futures Trading Commission (Feb. 10, 2014), *available at:* https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=59618

3. Letter from Timothy W. Cameron, Esq., Managing Director, Asset Management Group, Securities Industry and Financial Markets Association, and Matthew J. Nevins, Esq., Managing Director and Associate General Counsel, Asset Management Group, Securities Industry and Financial Markets Association, to Melissa Jurgens, Secretary, Commodity Futures Trading Commission (Feb. 10, 2014), *available at:* http://www.sifma.org/comment-letters/2014/sifma-amg-submits-comments-to-the-cftc-on-position-limits/

H. Proposed Rule for Position Limits for Derivatives and Aggregation of Positions (79 FR 37973; open, July 3, 2014)

1. Letter from Timothy W. Cameron, Esq., Managing Director, Asset Management Group, Securities Industry and Financial Markets Association, and Matthew J. Nevins, Esq., Managing Director and Associate General Counsel, Asset Management Group, Securities Industry and Financial Markets Association, to Melissa Jurgens, Secretary, Commodity Futures Trading Commission (Aug. 1, 2014), *available at:* http://www.sifma.org/comment-letters/2014/sifma-amg-submits-supplemental-comments-to-the-cftc-on-the-aggregation-proposal-relating-to-position-limits/

I. Proposed Rule for Position Limits for Derivatives and Aggregation of Positions (80 FR 10022; open, Feb. 25, 2015)

1. Letter from Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, Managed Funds Association, to Christopher Kirkpatrick, Secretary, Commodity Futures Trading Commission (Mar. 30, 2015), *available at:* https://www.managedfunds.org/wp-content/uploads/2015/03/MFA-CFTC-Position-Limits-Letter.final_.3.30.15.pdf

J. Supplemental Notice of Proposed Rule for Aggregation of Positions (80 FR 58365; open, Sept. 29, 2015)

1. Letter from Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, Managed Funds Association, to Christopher Kirkpatrick, Secretary, Commodity Futures Trading Commission (Nov. 12, 2015), *available at:* https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=60533

2. Letter from Timothy W. Cameron, Esq., Managing Director, Asset Management Group, Securities Industry and Financial Markets Association, and Matthew J. Nevins, Esq., Managing Director and Associate General Counsel, Asset

Management Group, Securities Industry and Financial Markets Association, to Christopher J. Kirkpatrick, Secretary, Commodity Futures Trading Commission (Nov. 13, 2015), *available at:* http://www.sifma.org/comment-letters/2015/sifma-amg-submits-comments-to-commission-on-aggregation-of-positions/

MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK

April 26, 2010

Via Electronic Mail: secretary@cftc.gov

David A. Stawick
Secretary
Commodity Futures Trading Commission
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Proposed Federal Speculative Position Limits for Referenced Energy Contracts And Associated Regulations

Dear Mr. Stawick:

Managed Funds Association ("MFA")[1] appreciates the opportunity to comment on the Commodity Futures Trading Commission's ("Commission") Notice of proposed rulemaking on Federal Speculative Position Limits for Referenced Energy Contracts and Associated Regulations (the "Notice"), which proposes to implement federal speculative position limits for futures and option contracts in certain energy commodities[2]. MFA recognizes that there has been a great deal of public focus on commodity price increases and volatility, and energy prices in particular, and the role and impact of speculators. We further understand that some voices have called for the Commission to impose additional restrictions on speculators (beyond those imposed by futures exchanges) to address energy price volatility and restore confidence in the price discovery function of futures markets.

We appreciate the Commission's efforts to respond to the concerns by publishing its Notice and seeking public comment. As longstanding market participants, we rely on fair, competitive, and transparent markets that respond to fundamental factors to conduct our businesses. MFA's members play a vital role in the energy futures markets by assuming the price risk from commercial participants (hedgers) on both the long and short sides of the market, and by providing liquidity that facilitates risk transfer and price discovery for businesses around the world. Some of MFA's members also invest in operating companies whose business involves the production, refining, merchandising or processing of energy and entities engaged in the development of energy market infrastructure (such as production, transportation or storage of energy)[3], and thus have an interest in enabling such entities to access liquid price discovery and risk shifting markets. We understand the Commission has issued the Notice to address the perception of excessive speculation causing an undue impact on energy prices.

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[1] MFA is the voice of the global alternative investment industry. Its members are professionals in hedge funds, funds of funds and managed futures funds, as well as industry service providers. Established in 1991, MFA is the primary source of information for policy makers and the media and the leading advocate for sound business practices and industry growth. MFA members include the vast majority of the largest hedge fund groups in the world who manage a substantial portion of the approximately $1.5 trillion invested in absolute return strategies. MFA is headquartered in Washington, D.C., with an office in New York.
[2] 75 Fed. Reg. 4144 (Jan. 26, 2010) (the "Notice").
[3] "The IEA [International Energy Agency], in its 2009 report, estimates $25 trillion must be spent just in energy supply infrastructure between now and 2030." Prepared Statement Before the Commodity Futures Trading Commission of Kevin Norrish, Managing Director of Commodities Research, Barclays Capital (March 25, 2010) ("Norrish Testimony"), at 4.

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Extensive studies have been undertaken by public and private institutions around the world on the energy price volatility of 2007-2008, seeking to identify and explain the underlying factors. The vast majority of reputable research has concluded that fundamental factors of supply and demand, along with economic factors such as the decline in the U.S. dollar, were responsible.[4] There was no evidence to indicate that excessive speculation was to blame.[5] In fact, longstanding research has shown, including by the Commission, that speculators perform essential functions to the energy markets by transferring risk from commercial participants, providing liquidity, reducing volatility, and contributing to the price discovery process, which benefits hedgers and all consumers and producers of energy.[6] Restricting this important service, and without establishing the need or fully assessing the cost, could have a significant negative impact. Indeed, economic analyses suggest that the likely result of the proposed federal limits would be a reduction in market participants' ability to transfer risk and hedge against future prices, greater volatility in energy prices over the long term, a reduction in liquidity on U.S. futures markets, and a flight of capital to overseas futures markets coinciding with decreased U.S. competitiveness.[7]

As the Commission engages in rulemaking, we respectfully urge it to carefully examine all relevant data and options. Rulemaking should be empirically driven and not a response to popular sentiment or partial analyses. Otherwise, it can become a vehicle for costly, detrimental and unintended consequences, and can severely impair the efficient functioning and competitiveness of U.S. energy markets.

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[4] See, e.g., "With Better Data, Better Understanding" (January 27, 2009), Lawrence Eagles, J.P. Morgan; MFA Analysis and Recommendations, "The Investor in a Sound Futures Market" (July 2008); CFTC Inter-Agency Task Force on Commodity markets—Interim Report on Crude Oil (July 2008); CFTC Staff Report on Commodity Swap Dealers & Index Traders (September 2008); HM Treasury Global Commodities: A long term vision for stable, secure and sustainable global markets (June 2008); IMF World Economic Outlook (October 2008); GAO Briefings to the House Committee on Agriculture on Issues Involving the use of Futures Markets to Invest in Commodity Indexes (December 2008); International Organization of Securities Commission's Technical Committee (IOSCO) Final Report (March 2009); CME Group white paper "Excessive Speculation and Position Limits in Energy Derivatives Markets", available at http://cmegroup.com/company/files/PositionLimitsWhitePaper.pdf.

[5] See, e.g., "Commodity Price and Futures Positions" (December 16, 2009), Ruy Ribero, Lawrence Eagles and Nicholas von Solodkoff, J.P. Morgan; "We can safely say there is no indication in this data of the fact speculators are pushing the price of oil," Christophe Barret, global oil analyst at Credit Agricole, quoted in Energy Risk (April 13, 2010), available at http://www.risk.net/energy-risk/news/1600919/cftc-speculators-influence-commodity-markets; Prepared Testimony of Philip K. Verleger, Jr,. Haskayne School of Management, University of Calgary, PKVerleger LLC, to U.S. Commodities Futures Trading Commission on The Role of Speculators in Setting the Price of Oil (August 5, 2009); "Speculators Cleared in U.K. Oil Volatility" (July 28, 2009), The Wall Street Journal; and "Interagency Task Force on Commodity Markets, Interim Report on Crude Oil" (July 22, 2008).

[6] See, e.g., "A Review of Recent Hedge Fund Participation in NYMEX Natural Gas and Crude Oil Futures Markets", New York Mercantile Exchange, March 1, 2005; "Price Dynamics, Price Discovery and Large Futures Trader Interactions in the Energy Complex, Working Paper First Draft: April 28th 2005", Michael S. Haigh, Jana Hranaiova and James A. Overdahl, Office of the Chief Economist, U.S. Commodity Futures Trading Commission ("Commission Energy Complex Report"); Testimony of Craig Pirrong, Professor of Finance, Director, Global Energy Management Institute, Bauer College of Business, The University of Houston, Before the House Committee on Agriculture (July 7, 2008) ("Pirrong Testimony"); "Populists versus theorists: Futures markets and the volatility of prices" (June, 2006),Explorations in Economic History 44 (2007) 342-362, David S. Jacks ("Jacks Study"), available at www.sciencedirect.com.

[7] See, e.g, Testimony of Todd E. Petzel, Ph.D., Chief Investment Officer, Offit Capital Advisors, CFTC Hearings to Discuss Position Limits, Hedge Exemptions and Transparency for Energy Markets (July 28, 2009); Testimony of Donald Casturo, Managing Director, Goldman, Sachs & Co., CFTC Hearings to Discuss Position Limits, Hedge Exemptions and Transparency for Energy Markets (July 29, 2009).

We also note that under Section 15(a) of the Commodity Exchange Act (the "CEA"), in considering or determining whether an action is necessary or appropriate to protect the public interest, the Commission must consider, in addition to the protection of market participants and the public, whether the action will promote efficiency, competitiveness and financial integrity of the market for listed derivatives.

In this case, in our view it appears that the empirical data do not support the need for federal speculative position limits in energy contracts, and that the proposed federal limits might harm U.S. energy markets through decreased liquidity and pricing efficiency, and greater transaction costs resulting from such decreased liquidity and wider bid-ask spreads. As a result, if the Commission does make a finding under CEA§ 4a(a) that additional measures are needed, then we urge it to consider more effective alternatives, such as those suggested below in Section IV.G, including greater transparency, increased data gathering to identify market manipulation, and strict prosecution of abusive market practices.

I. EXECUTIVE SUMMARY

- Research and experience demonstrate that hard position limits have not reduced price volatility or prevented market manipulation. Commissioner O'Malia noted as much at the Commission's January 26, 2010 hearing with respect to the agriculture markets.[8] Thus, it is not clear how the proposed federal limits will achieve their intended purpose with respect to energy markets. In fact, MFA fears that the Commission's proposals may actually undermine its intent to encourage market transparency and reduce systemic risks through centralized clearing, as participants may be forced to move their transactions to less transparent and non-cleared markets.

- Further, academic and governmental studies and real world examples show that policies restricting investor access to futures markets only impair commercial participants' ability to hedge and restrict the use of risk management tools. The proposed federal limits will likely result in decreased market liquidity, which in turn will impair the ability of commercial market participants to hedge against rising prices. Proposed federal limits are also likely to increase the risk exposure of commercial participants and ultimately raise energy prices over the long run.

- Restricting trading on U.S. futures markets may drive trading overseas, reducing the competitiveness of U.S. markets. In light of the global nature of energy commodity markets, the portability of trading capital and resources across borders, and the existence of a robust OTC energy market, before acting on its own the Commission should reach agreement with its counterparts in other G-20 countries to arrive at a comprehensive, consistent, and effective approach across related markets.

- The Commission has not met its statutory burden in proposing the federal limits. It has not found as required by CEA § 4a(a) that the proposed federal limits are necessary to prevent the burdens of "excessive speculation" in the energy markets. Nor has the Commission demonstrated that: (1) excessive speculation exists or has been the cause of recent undue price volatility in the energy markets; (2) it has the legal authority to restrict hedgers that are relying on a hedge exemption from engaging in speculative trading in addition to their risk management activities; and (3) it could not achieve its goals through less burdensome and more flexible methods.

[8] Notice, Concurring Statement of Commissioner O'Malia, at 4172.

- The costs of the proposed federal limits far outweigh the benefits. The Commission underestimates the number of affected parties, the costs to the market of compliance with the proposed rules and the potential unintended consequences. Such consequences are likely to include decreased liquidity and increased price volatility, resulting in higher transaction costs as the bid-offer spreads widen in the futures and OTC markets, and less market transparency and more systemic risk as participants move to less transparent trading venues and/or bilateral, non-cleared transactions. Other consequences include unnecessary constraints on corporate structures and the amount of capital available for investment in commodity operating companies and commodity infrastructure, and considerable administrative burdens and costs in monitoring and complying with multiple overlapping and inconsistent federal and exchange limits, position aggregation requirements, and hedge exemption procedures.

- MFA urges the Commission to consider the availability of alternative approaches. Such alternatives might include implementing aggregate position accountability levels, requiring more comprehensive reporting of positions by traders in all related trading venues, publishing more information about hedger and swap dealer positions in OTC and exchange markets, and using additional resources to expand its current monitoring and enforcement programs.

II. BACKGROUND

The Commission's stated purpose in considering the Proposed Federal Limits is to prevent the "unreasonable and abrupt price movements that are attributable to large or concentrated speculative positions"[9] and to curb the purported impact of disruptive, excessive speculation by imposing "Federal speculative position limits for futures and options contracts in certain energy commodities and aggregate position limits that would apply across economically similar contracts, regardless of whether such contracts are listed on a single or on multiple markets."[10]

MFA agrees that any market participant intentionally creating artificial prices undermines the integrity of the futures markets. We fully support the Commission's efforts to combat market manipulation and protect the integrity of the market. Congress has granted the Commission broad authority to sanction persons who engage in manipulative behavior. Indeed, one of Congress' central goals in enacting the CEA was to prevent price manipulation and/or any other disruptions to market integrity.[11]

MFA notes that Congress provided that this important goal is to be achieved through a "system of effective self-regulation of trading facilities, clearing systems, market participants and market professionals under the oversight of the Commission".[12] MFA also notes that Congress found that such regulatory imperative is intended to serve the "national public interest of providing a means for managing and assuming price risks, discovering prices, or disseminating pricing information through trading in liquid, fair markets".[13]

MFA believes that, when the Commission exercises its regulatory oversight authority, it must be cognizant of the effect of the proposed federal limits on the ability of futures markets to perform their

[9] Notice, at 4148.
[10] Id. at 4149.
[11] CEA § 3(b).
[12] Id.
[13] Id. and CEA § 3(a).

fundamental price discovery, risk transfer and risk management functions, which depend on the existence of liquid, fair and competitive markets. Therefore, any proposal that would tend to adversely affect the liquidity, fairness or competitiveness of the futures markets must be carefully scrutinized.

MFA respectfully suggests that the Commission may better achieve its goals by further developing and implementing its ongoing energy market transparency initiatives, such as: adopting aggregate position accountability levels across economically equivalent products on all related trading venues; requiring more comprehensive reporting of positions (both exchange-traded and OTC transactions) by large traders, swap dealers and hedgers; implementing more frequent collection of such information by the Commission; using such data to detect instances of manipulation or attempted manipulation; and bringing vigorous enforcement actions against participants who create artificial prices in the energy market.

III. THE PROPOSALS

The Commission's proposed rulemaking would:

- Establish federal speculative position limits on four "referenced energy commodities", specifically: Henry Hub natural gas, light sweet crude oil, New York Harbor No. 2 heating oil and New York harbor gasoline blendstock, and any other contract that is based on the referenced commodity (except for basis contracts and diversified commodity indexes)[14];

- Apply to derivatives contracts in the referenced energy commodities traded on or subject to the rules of "reporting markets"[15], i.e., derivatives contract markets ("DCMs"), such as the New York Mercantile Exchange Inc. ("NYMEX"), and exempt commercial markets that list significant price discovery contracts ("ECM-SPDCs"), such as ICE;

- Establish separate limits for the spot-month, any single month, and all-months-combined.[16] The single month (outside of the spot-month), and all-months-combined limits would be set at both the reporting market level[17] and as aggregate limits across all reporting markets (i.e., DCMs and ECM-SPDCs) listing the referenced energy commodities[18];

- Set aggregate limits by reference to an open interest formula. The all-months-combined position limit would be 10% of the first 25,000 of open interest and 2.5% of open interest above 25,000 contracts.[19] The single-month position limit would be set at 2/3rds of the all-months-combined limit[20];

- Establish a limit for the spot-month physically-settled contract at 25% of the estimated deliverable supply[21], and a limit for cash-settled contracts in the spot-month of five times the limit of the physically-settled contract. However, if a trader holds a position in the physically-settled spot-month

[14] Proposed Regulation § 151.1.
[15] Proposed Regulation § 151.1 and § 15.00.
[16] Proposed Regulation § 151.2.
[17] Proposed Regulation § 151.2(b)(2).
[18] Proposed Regulation § 151.2(b)(1).
[19] Proposed Regulation § 151.2(b)(1)(i).
[20] Proposed Regulation § 151.2(b)(1)(ii).
[21] Proposed Regulation§ 151.2(a)(1).

contract, the applicable cash-settled limit would be the same as the limit fixed for the physically-settled contract (the "conditional limit")[22];

- Require the CFTC to reset the limits by January 31st of each calendar year[23];

- Be in addition to, and not replace, position limits and position accountability levels established by DCMs and ECM-SPDCs[24];

- Provide for hedge exemptions from the limits for bona fide commercial hedgers[25];

- Provide for a limited risk management exemption (outside of the spot-month) for swap dealers establishing positions to offset customer initiated swap positions (with such exemption capped at two times the otherwise applicable single-month or all-months-combined limit)[26];

- Provide that a hedger or swap-dealer with an exemption could not also maintain speculative positions in the same contracts in which they have been granted an exemption (the "crowding-out provision")[27];

- Provide that aggregation of positions would be required for position limit calculation purposes based upon common ownership of 10% or more, without any exception for independence of control of commonly owned accounts[28]; and

- Require reporting to the Commission of certain cash and derivatives position data by all persons that (1) acquire positions in a referenced energy contract pursuant to the conditional-spot-month limit[29], (2) obtain bona-fide hedge exemptions[30], or (3) obtain a swap dealer exemption[31].

The Commission has requested comment on all aspects of the proposed rulemaking, as well as on eighteen enumerated questions included in the Notice. MFA has numerous concerns with the proposed rulemaking, as we explain below.

IV. COMMENTS

A. The Proposed Federal Limits Are Unlikely To Achieve The Desired Result.

We believe that the hard position limits proposed in the Notice will neither keep energy prices from fluctuating in response to supply and demand factors nor promote market integrity. Rather, they will hinder commercial risk management.[32] Speculators absorb risk from hedgers and provide liquidity.[33]

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[22] Proposed Regulation § 151.2(a)(2).
[23] Proposed Regulation § 151.2(f).
[24] Notice, at 4145.
[25] Proposed Regulation §151.3(a)(1) and §20.01.
[26] Proposed Regulation §151.3(a)(2) and § 1.45.
[27] Proposed Regulation § 151.3(a)(1)(i), (ii), and (2).
[28] Proposed Regulation § 151.4(a)(1).
[29] Proposed Regulation § 20.00(b).
[30] Proposed Regulation § 20.01(b).
[31] Proposed Regulation § 20.02(a) and (b).
[32] See, for example, Pirrong Testimony, at 3.

Position limits, even purportedly generous ones, may impair the ability of markets to serve their essential risk shifting function, which would increase the cost of managing risk and harm hedgers, and ultimately consumers of energy products.[34] Studies have demonstrated that on prior occasions where trading by investors was restricted, such as by prohibiting futures transactions in certain commodities (Chicago onions, Berlin wheat), the result was significantly greater, and not less, price volatility.[35] Studies comparing price volatility in various commodities (wheat, cotton, oats, sugar, butter, eggs, rubber, silk, copper, silver, lead, zinc, soybeans, linseed, and hogs) before and after the establishment of futures markets for such commodities also demonstrate that futures markets are associated with lower price volatility.[36]

Although position limits may reduce the ability of persons with market power to squeeze or corner the market, they have been described as a crude and inefficient tool.[37] This is because it is difficult to set the limits at a level that inhibits market manipulation without unduly affecting the ability of markets to efficiently transfer risk.[38] We recommend alternatives to using such a blunt instrument.

The Commission states that it has modeled the proposed federal limits after the current federal speculative position limits applicable to agricultural commodities. However, the Commission offers no empirical support for the proposition that hard position limits have reduced undue price volatility in agricultural commodities or will reduce volatility in energy markets.[39] As Commissioner O'Malia observed at the Commission's January 26, 2010 hearing, it is not clear that hard position limits in the agricultural markets have prevented price spikes in those markets.[40] Moreover, the Commission does not explain why the agricultural model would be correctly applied to energy in view of the different characteristics that distinguish these markets. For example, the energy markets are more global, energy commodities are more fungible, supplies of energy commodities are much greater and production is subject to less seasonal variation than with agricultural commodities.

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[33] "The short hedgers and long investors provide liquidity for each other by using futures markets to serve their respective interests in a open, transparent and efficient manner. Liquidity will be essential to make sure each can achieve their objectives at an efficient price. Artificial limits on that liquidity should not be imposed. There are numerous ways to further the objectives of enhanced transparency and reduced systemic risk that do not involve reductions in much needed liquidity." Norrish Testimony, at 4.

[34] Id. See, also "Streetwise Professor: Now I Know How Sisyphus Felt" (July 8, 2009), by Dr. Craig Pirrong, at 4, available at http://streetwiseprofessor.com/?p=2099; see also, "Commodities and Speculators: Argument for Position Limits Non-Existent" (October 5, 2009), in Hard Assets Investor, interview of Dr. Craig Pirrong by Associate Editor Lara Crigger, available at http://seekingalpha.com/article/164814-commodities-and-speculators-argument-for-position-limits-non-existent.

[35] "At a minimum, there is no evidence for the claim that futures markets are associated with higher price volatility. Indeed, the results presented in this paper strongly suggest the opposite: futures markets were associated with, and most likely caused lower commodity price volatility." Jacks Study, at 357.

[36] Jacks Study, at 352.

[37] Pirrong Testimony, at 5.

[38] Id.

[39] "[W]e do not believe a case has been made which demonstrates that prices of commodities, or other financial derivatives, can be effectively controlled through the mandatory operation of regulatory tools such as position limits, whether on exchange or OTC. Analysis of market data where position limits are already in use suggests this has not shown a reduction in volatility or absolute price movements compared to contracts where they are not." Financial Services Authority & HM Treasury, Reforming OTC Derivative Markets, A UK perspective ("FSA & HM Treasury Report") (December 2009), at 34.

[40] Notice, at 4172.

Additionally, MFA respectfully questions whether the Commission's approach will promote the goal of preserving market integrity. As the imposition of hard limits on U.S. futures exchanges drives more trading to other markets, the Commission will have more difficulty conducting effective market surveillance and preventing potential price manipulation. Moreover, it is currently a fundamental part of the proposed financial markets regulatory reform effort promoted by the Commission to encourage clearing of derivatives transactions through central counterparties to increase market transparency, promote financial integrity and reduce systemic risks.[41] We believe the proposed federal limits will have just the opposite effect, as participants will be induced to effect trades in less transparent OTC markets and settle such trades on a bilateral basis.

We believe there are better alternatives than hard position limits to deter market manipulation. Corners, squeezes and other forms of manipulation can be detected. It is preferable, therefore, to use readily available market data and the Commission's existing statutory authority to investigate and prosecute aggressive traders that manipulate or attempt to manipulate the market, than to limit the trading activity of all other market participants through hard position limits.

B. The Proposed Federal Limits Will Reduce Liquidity On U.S. Futures Markets.

The Commission's own studies and other governmental studies have found that commodity trading advisors such as MFA's members, termed "managed money speculative traders," are an important source of futures market liquidity for energy commodities and help to act as a shock absorber for commercial (i.e., hedger) order flow.[42] The proposed federal limits will generally reduce the liquidity provided by managed money traders. Aside from the overall imposition of hard limits, there are several aspects of the proposed rule that we believe will significantly impact liquidity in the energy futures markets.

1. <u>Adverse Effect of Conditional Limit In The Spot Month</u>

Under the proposed spot month conditional limit, a trader holding cash-settled contracts would be subject to a spot-month position limit of five times the level fixed for the cash-settled contract's physically-settled counterpart if the trader holds <u>no</u> physically-settled contracts in the spot month. But if the trader holds even one physically settled contract in the spot month, the trader in cash-settled contracts would be subject to the much lower limit fixed for a contract's physically-settled counterpart. MFA's members believe that the conditional limit is too low and will constrain liquidity. The conditional limit will cause spot month liquidity to collapse three days before contract expiry (or even earlier) by either forcing speculative traders out of physically-settled contracts in the spot month during the last three days of trading or restricting the cash-settled positions of those traders that choose to maintain some physically-settled contracts.

[41] "We must bring all standardized over-the-counter derivatives onto transparent and regulated exchanges or similar trading venues to lower risk and improve pricing in the marketplace… to further lower risk, we must bring all standardized over-the-counter derivatives into central clearinghouses." Remarks of Chairman Gary Gensler, Over-the-Counter Derivatives Reform, Council of Institutional Investors, Washington, D.C. (April 13, 2010).

[42] "[W]e observe that indeed, the largest speculative category [managed money traders] provides liquidity to the market and enhances the price discovery function." Commission Energy Complex Report at 25. "…[R]esults from DAG analysis suggest that it is the [managed money traders] that are providing liquidity to the large hedgers and not the other way around." Id., at 38.

While it is too early to empirically demonstrate, MFA's members are concerned that the implementation by NYMEX in February 2010 of a rule that adopted the conditional limit methodology proposed by the Commission is having a negative impact on liquidity, and is causing increased volatility and wider price spreads in the spot month trading in NYMEX Henry Hub Natural Gas contracts. The Commission should study the effects of the conditional limit (on NYMEX and ICE) in consideration of the impact of the proposed rule. In doing so, it should also consider revising the current conditional limit methodology and raising the cash-settled limit to a more appropriate level, above five times the physical limit.

2. Adverse Effect of Crowding Out Provision on Liquidity

The "crowding out provision" of the proposed rules will also adversely affect liquidity. That provision, applicable to participants with a bona fide hedge exemption or swap dealer exemption, would prohibit such participants from holding speculative positions if they are relying on an exemption. Under the CEA, and under the hedge exemption and risk management exemption policies administered by U.S. futures exchanges, every participant, including hedgers and swap dealers, is permitted to hold speculative positions below the established speculative positions limits. And, in fact, many bona-fide hedgers and swap dealers also engage in speculative trading within the applicable speculative position limits and can be important sources of market liquidity.[43] In the Notice the Commission does not provide any support for the need to bar hedgers and swap dealers from engaging in speculative trading.

Because hedging and risk management is generally performed on a portfolio basis, and not on a position by position basis, on a practical level it will be very difficult, if not impossible, for bona fide hedgers and swap dealers to monitor and comply with the provision barring them from holding any speculative futures positions. This will almost certainly result in a loss of liquidity on U.S. futures markets as trading will migrate to markets where no such restrictions apply.

Our understanding of the policy administered by the Chicago Mercantile Exchange ("CME"), Chicago Board of Trade ("CBOT") and NYMEX is that every participant is entitled to a position up to the applicable speculative position limit, unless there is market congestion. In such case a smaller limit may be imposed. Bona fide hedgers may apply to the exchange for an exemption to hold a position greater than the speculative limit. The application requires a demonstration of risk exposure at the time the request for exemption is made. If the demonstration is sufficient, the exchange approves the request. The "extra" hedge or risk management position size is permitted for hedging purposes, on top of the speculative limit, with the following qualification. In all cases, for all commercial hedgers and all other entities (such as swap dealers) who are accorded any kind of risk or spread exemptions, the approval of an exemption carries the condition that the firm must be able to demonstrate, at any point in time, that its current position in excess of speculative limits, by any amount, is demonstrably equivalent to its actual current risk exposure. If not, then the firm is subject to position limit rule enforcement procedures, and possible revocation of its exemption. We believe that this exchange policy is appropriate to prevent a trader with an exemption from abusing that privilege and the Commission should consider it in lieu of its proposed crowding out provision.

[43] "Swap dealers perform a critical risk-warehousing function in these markets…providing long-term liquidity where there would otherwise be none, even for very standard products such as oil and natural gas." Norrish Testimony, at 4.

3. Adverse Effect of Aggregation Policy on Liquidity

a. Disaggregation Of Independent Account Controllers Has Been The Longstanding Policy Of The Commission

The limitation on disaggregation of independent account controllers in the proposed rules will also adversely affect liquidity. Disaggregation based upon independence of control has been a longstanding policy of the Commission and U.S. futures exchanges.[44] The Commission has historically required aggregation of positions on the basis of ownership of positions or control of trading decisions. For this purpose, a trader holding accounts or positions in which the trader directly or indirectly has a 10% or greater ownership or equity interest generally must aggregate all such accounts or positions. Over the years, by regulation and interpretative letters, the Commission has provided relief from having to aggregate accounts or positions on the basis of ownership where discretion over trading is granted to an independent third party. The premise of such relief is that the beneficial owner in these cases does not directly or indirectly control the trading of the accounts or positions involved.

Under Commission Rule 150.3(a)(4), a commodity pool operator ("CPO"), commodity trading advisor ("CTA"), bank or trust company, an insurance company, or the operator of trading vehicle that is excluded or has qualified for an exemption under Commission Regulation 4.5 (each, an "eligible entity") need not aggregate positions carried for it by an "independent account controller"[45] except in the spot month if there is a spot month limit. If an independent account controller is affiliated with the eligible entity or another independent account controller trading on behalf of the eligible entity, each of the affiliated entities must: (1) maintain written procedures to preclude them from having knowledge of, or gaining access to, trades of the other, including document and order routing arrangements or separate physical locations; (2) trade such accounts pursuant to separately developed and independent trading systems; (3) market such trading systems separately; and (4) solicit such funds by using separate disclosure documents (where such documents are required under Commission rules).

Under Commission Rule 150.4(b), a trader who is a limited partner or shareholder in a commodity pool (other than the pool's CPO) with an ownership or equity interest of 10% or more in the pool generally need not aggregate the pool's positions so long as such trader does not control the trading

[44] See e.g., the Aggregation Policy (exemption from aggregation for futures commission merchant managed account programs utilizing independent commodity pool operators); Adoption of Commission Regulation 150.3(a)(4), 53 Fed. Reg. 415653 (October 24, 1988)(extending the Aggregation Policy exemption for multi-advisor commodity funds); Exemption From Speculative Position Limits for Positions Which Have a Common Owner, But Which Are Independently Controlled, 56 Fed. Reg 14308 (April 9, 1991) (extending the exemption to commodity trading advisors); Amendment of Commission Regulation 150.3, 57 Fed. Reg. 44492 (September 28, 1992) (making the exemption for eligible entities self-executing); CFTC Interpretative Letter No. 92-15 (where an FCM is one of the components of a larger organization, the Aggregation Letter exemption would apply, even where the CPO/CTA were being operated as a separate subsidiary of a common parent); Amendment of Commission Regulation 150.1(d) and 150.4, 64 Fed. Reg. 24038 (May 5, 1999) (to expand the categories of eligible entities that authorize independent account controllers to trade on their behalf to the separately organized affiliates of an eligible entity); and CFTC Regulation 150.4(c) (disaggregation for ownership by limited partners, shareholder or other pool participants). Also, see NYMEX Rule 559.E.

[45] For this purpose an independent account controller is defined as a person who: trades independently on behalf of an "eligible entity" such as a CPO or CTA; over whose trading the CPO or CTA maintains only such minimum control consistent with its duty to supervise diligently the trading done on its behalf; who has no knowledge of any trading decisions by any other independent account controller acting on its behalf; and who is separately registered as a CTA or an associated person of a CTA. Commission Regulation 150.1(d).

of such pool. Moreover, under Commission Regulation 150.4(c)(2) if the trader who is a limited partner or shareholder with an equity or ownership interest of 10% or greater in the pool is an affiliate of the pool's CPO, the trader need not aggregate the pool's positions, provided that: (1) the pool's CPO maintains written procedures to preclude the trader from having knowledge of, or gaining access to, the pool's trading or positions; (2) the trader does not have direct, day-to-day supervisory authority or control over the pool's trading decisions; and (3) if the trader is a principal of the pool's CPO, the trader maintains only such minimum control consistent with its responsibilities as a principal and its duty to supervise the pool's trading activities.

Additionally, Commission staff has provided no-action relief from having to aggregate positions on the basis of taking a 10% or greater ownership or equity interest in another entity on a case-by-case basis, where, among other things, trading is conducted separately and independently by or on behalf of the two affiliated entities.

The Commission now proposes to prohibit previously eligible entities from disaggregating positions pursuant to the Commission's longstanding independent account controller framework. Under proposed Regulation 151.4(a)(1) aggregation would be required based upon common ownership of 10% or more, without any exception for independence of control. In addition, under proposed Regulation 151.4(b), a passive limited partner or shareholder with an ownership of 25% or more in a commodity pool, with no ability to control the trading of the pool, would be required to aggregate the pool's positions.

b. Many Asset Managers Use Independent Account Controllers.

An asset manager may legitimately access multiple active and passive trading programs that are independently managed by independent account controllers. Some programs involve short-term trading strategies, some are long-term, some are based on market fundamentals and some are based on technical signals. Asset managers may also invest through "funds of funds" structures which allow their investors to have access to various and diversified independently managed investment approaches. An asset management firm may also own, in whole or in part, or through private equity investments, utilities, producers of energy or other energy companies, and need to hedge those exposures independently from other trading strategies.

In all of the foregoing scenarios there is the possibility that these independently controlled accounts will be 10% or more commonly owned. The proposed aggregation rule would require that all such accounts be aggregated for position limit purposes, notwithstanding the independence in trading control. All of the above-described investment approaches provide (and require) different types of market liquidity, and if such investments are independently controlled, we can see no reason nor has the Commission given any reason to depart from its long-standing exception for independently controlled accounts from its aggregation policy.[46] By preventing asset managers from disaggregating independent account controllers for purposes of position limits, asset managers and/or independent account controllers to whom they allocate assets may be compelled to reduce their participation in US energy futures markets, and/or shift their business to other venues, resulting in a reduction of market liquidity on U.S. futures exchanges. Furthermore, it would undermine their ability to invest, in whole or in part, in a range of energy and energy-related projects vital to the economy.

[46] Statement of Aggregation Policy and Adoption of Related Reporting Rules, 44 Fed. Reg. 33839 (June 13, 1979) (the "Aggregation Policy").

Asset managers and corporate enterprises should be free to allocate capital efficiently across all types of business lines, including speculative trading ventures and commercial enterprises without fear that the independent trading operations of various commonly owned but independently operated businesses will be subject to aggregated limits, possibly affecting the ability of two or more independently controlled, but commonly owned businesses to trade in a particular market. We also note that the proposed rule would effectively require otherwise independent trading operations of commonly owned enterprises to communicate with each other as to their trading positions and intentions so as to avoid violating position limits. Such communications would actually raise the potential for trading in concert, which is precisely the sort of behavior that the proposed rules seek to avoid.

c. The Lack of Disaggregation Relief Will Significantly Impact Asset Managers and Market Liquidity.

The absence of independent account controller relief from aggregation, combined with the proposed crowding out provision prohibiting hedgers or swap dealers from engaging in speculative trading may require commodity trading advisors that invest in multiple lines of business (i.e., production, processing, merchandising, commercial use, dealing in swaps and/or speculation in commodities) to either sell or spin off ongoing businesses or refrain from hedging in US futures markets, adversely impacting the price discovery function of such markets and reducing liquidity in futures markets.

As noted above, some asset managers have investments in operating companies engaged in the production, processing, commercial use or merchandising of commodities or in energy commodity infrastructure companies. Aggregation of independent account controllers in 10% or more commonly-owned enterprises will have the effect of limiting the amount of capital available to invest in such enterprises and will have a detrimental effect on the development of energy commodities infrastructure.[47]

Energy commodities should not be treated differently from agricultural (or any other commodities) with respect to the Commission's aggregation policy. The need to comply with two different aggregation regimes will create significant confusion and administrative burdens. Moreover, the Commission's adoption of a more restrictive aggregation policy for referenced energy commodities is likely to spill over to other energy products and to other non-energy commodities because exchanges tend to take their cue from the Commission in applying and interpreting their aggregation policies. Because it will be burdensome for exchanges and carrying brokers to administer two different aggregation policies, the end result may be that all energy commodities and all other commodities will be subject to an aggregation policy that is more restrictive than is necessary.

d. The Solution Is To Audit and Enforce Independent Account Controller Information Barrier Policies and Procedures.

With respect, the Commission has not pointed to any problems or abuses in energy commodity markets arising out of the application of the current independent account controller exemption permitting disaggregation that would require a different rule in the energy market. If the Commission is concerned that the information barriers constructed between commonly owned enterprises are inadequate for the purposes of maintaining true independence among account controllers, it would seem to us that an appropriate regulatory response would be to audit for the adequacy of, and compliance with, such

[47] "Given the vast scale of capital spending needs, deep and liquid markets are essential to help facilitate the hedging of price risk inherent in these investments, stabilizing cash flows to support financing and construction." Norrish Testimony, at 4.

information barrier policies and procedures, rather than to automatically require aggregation. The Commission already has access to information regarding cross-ownership of traders through its Statement of Reporting Trader forms and may use this information to ensure segregation of trade information.

While we acknowledge the difficulty of quantifying in advance the potential individual effect of each of the impacts on market liquidity noted above, there can be no denying that the cumulative impact is likely to be significant.

C. The Proposed Federal Limits Will Hurt the Competitiveness of Commission Regulated Markets and U.S. Energy Markets.

MFA fears that the Commission's unilateral imposition of aggregate position limits on contracts traded on U.S. exchanges and trading facilities will drive business offshore or to OTC markets, adversely affecting the liquidity, transparency and competiveness of U.S. futures markets, and thus impacting the price discovery and risk shifting purposes of such markets. There is no consensus among foreign regulators that strict position limits are necessary or desirable.[48]

The flight to foreign and OTC markets has already begun. United States Oil Fund has been moving a considerable portion of its energy futures trading from NYMEX to London and to OTC markets.[49] Additionally, Standard & Poors recently announced the launch of a commodity index that excludes all US exchange-traded commodities, instead choosing as index components contracts listed on foreign commodity markets.[50]

In light of the global nature of energy commodity markets, the portability of trading capital and resources across borders, and the existence of robust OTC derivatives markets, MFA believes that before acting on its own the Commission must reach agreement with its counterparts in the G-20 countries to arrive at a comprehensive, consistent, and effective approach across related markets. The failure to do so threatens to send significant liquidity overseas, harming the price discovery and risk shifting capacity of U.S. energy markets.

D. The Commission Has Not Met Its Statutory Burden In Proposing The Federal Limits

The Commission has not made the required statutory findings to support adoption of the proposed rules. CEA § 4a(a) provides that the Commission must make a finding that its position limit rules are necessary to diminish, eliminate or prevent the burden on interstate commerce caused by sudden, unreasonable or unwarranted price fluctuations arising out of excessive speculation in contracts for future delivery traded on contract markets or electronic trading facilities. The Commission's Notice focuses on the prevention of undue concentration of positions, but ownership of a concentrated position, standing alone, is not the same as excessive speculation.

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[48] "As we have outlined the current broad position management approach adopted in the UK is effective in combating market manipulation and so we see no need to introduce position limits for this purpose. With regards to controlling or limiting price movement we have not seen evidence that a position limits regime is needed." FSA & HM Treasury Report, at 36.

[49] "US watchdog probes ETF's oil contract stake", article by Javier Blas and Joanna Chung, The Financial Times (February 27 2009).

[50] "S&P index seeks to bypass US clampdown", article by Chris Flood, The Financial Times (March 18, 2010).

Respectfully, the Commission has ignored the studies of its own economists (as well as third parties) concluding that there was no link between speculative trading and the price spikes in energy contracts in 2008 and in prior years.[51] Moreover, the Commission has not provided any evidence that the proposed rule will help reduce price fluctuations nor could it. Rather, studies indicate that hard position limits have not been shown to alleviate undue price volatility. If the Commission proceeds with this rulemaking it is obliged to present empirical evidence: (1) of excessive speculation in the relevant energy markets; (2) that such excessive speculation caused sudden, unreasonable or unwarranted price fluctuations; and (3) that its rules are the most appropriate means of diminishing, eliminating or preventing the burden caused by such price fluctuations.

Nor do we believe that the Commission has the authority to condition the grant of a hedge or swap dealer exemption on the recipient of such relief being required to refrain from speculative trading (the crowding out provision). CEA § 4a(c) states that "No rule, regulation, or order issued under subsection (a) of this section shall apply to transactions or positions which are shown to be bona fide hedging transactions or positions…." We read this to effectively provide a hedger with an exemption from speculative position limits authorized under CEA § 4a(a) for all positions that qualify as bona fide hedges. By counting a hedger's bona fide hedge positions against such trader's speculative position limit, the Commission's crowding out provision would effectively convert bona fide hedge positions into speculative positions, which is inconsistent with CEA § 4a(c). As noted above, the futures exchanges do not apply such a policy in their administration of their hedge exemptions and we would urge the Commission to adopt an approach consistent with that implemented by the exchanges.

E. The Purported Benefits Of The Proposed Federal Limits Are Far Outweighed By The Costs.

MFA has several concerns regarding the potential costs and burdens on market participants of compliance with the proposed federal limits. The Commission's cost/benefit analysis underestimates the substantial costs and burdens that would be imposed by the proposed rules. The proposed federal limits are complex and must be layered on top of existing exchange position limits and position accountability levels. Traders will be required to compute and aggregate their positions across contract types and across trading platforms on a real time basis so as to permit effective compliance with the multiple layers of individual and aggregated position limits. Additionally, traders operating in commonly owned entities will also be required to perform these calculations across all related entities. We are not aware of any existing automated system that is readily available to the commodity trading advisor community to perform this task. The systems development burdens and costs of accomplishing this task are not insignificant.

In addition, the Commission's estimate that the rulemaking will affect "possibly 10 traders"[52] does not take into account the number of entities that will be affected by the Commission's aggregation

[51] For example, the Commission Energy Complex Report explored the relationship between futures prices and the positions of managed money traders (MMTs), commonly known as hedge funds, for the natural gas and crude oil futures markets and examined the relationship between the positions of MMTs and positions of other categories of traders (e.g., floor traders, merchants, manufacturers, commercial banks, dealers) for the same markets. The results of the study found "no evidence of a link between price changes and MMT positions (conditional on other participants trading) in the natural gas market, and find a significantly negative relationship between MMT position changes and price changes (conditional on other participants trading) in the crude oil market…."
[52] Notice, at 4165.

rule and the significant burdens that such rule will impose. Nor does it take into account the effect that the reduced liquidity on U.S. energy futures markets will have on market participants in general.

MFA is concerned that the Commission underestimates the costs of compliance with the proposed federal limits, and that the potential unintended consequences of the rules will greatly outweigh any purported benefits. Such consequences are likely to include decreased liquidity and increased price volatility, resulting in higher transaction costs as the bid-offer spreads widen in the futures and OTC markets and less market transparency. In addition, the Commission does not appear to have considered either the constraints on corporate structures, the amount of capital available for investment in commodity operating companies and commodity infrastructure, or the considerable administrative burdens and costs in monitoring and complying with multiple overlapping and inconsistent exchange and federal limits, position aggregation requirements, and hedge exemption procedures.

MFA respectfully believes that many of these costs and burdens could be alleviated if the Commission were to adopt an approach that is more consistent with the framework currently implemented by U.S. futures exchanges.

F. Other Significant Concerns With The Proposed Federal Limits

In the following section MFA outlines several additional concerns regarding the proposed rules.

1. The Commission should provide greater detail as to the purpose and rationale of the proposed rules, the specifics on its computations, and the data it used to calculate aggregate open interest and deliverable supply.

a. Particularly with respect to options, the Commission has not explained whether option open interest is calculated on a gross basis or a net basis (i.e., are long calls and long puts at the same strike price calculated on a net or gross basis) and the rationale for its option methodology.

b. Transparency into the calculation methodology (and the actual underlying numbers used by the Commission in its open interest calculations) is important to allow interested persons to judge the validity of the assumptions underlying the proposed limits and to permit compliance by market participants on an ongoing basis if the rules are adopted. For example, we note a significant discrepancy between the prospective all-months-combined limits published in the Notice and the limits presented by the CFTC at its open hearing discussing the proposed federal limits.[53] We also note that it is difficult to obtain timely and complete options open interest data from the exchanges. For example, it has been difficult to obtain open interest information broken down by option strike prices. Thus, participants that wish to independently forecast the positions limits in the next year and manage their portfolios effectively will have difficulty doing so. An opaque process without timely and transparent access would disrupt trading activity and increase the potential for non-fundamental or political factors being introduced.

c. The Commission's proposed spot month limits will be based upon the deliverable supply of the underlying commodity. While that approach may have some justification for physically-settled

[53] For example, on page 6 of the Statement of Steve Sherrod, Acting Director of Surveillance, Division of Market Oversight, Commodity Futures Trading Commission (January 14, 2010), the prospective All Months Combined Speculative Position Limits were listed as 98,200 for Crude Oil, 8,900 for Harbor Gasoline Blendstock, 13,100 for Heating Oil and 117,300 for Natural Gas, whereas in the Notice, the proposed limits were 98,100 for Crude Oil, 9,000 for Harbor Gasoline Blendstock, 9,000 for Heating Oil, and 132,700 for Natural Gas (Notice, at 4162).

contracts, there is no economic relationship or rationale for linking positions limits on cash-settled contracts to deliverable supply. The Commission has not explained its rationale for doing so. Nor has the Commission disclosed the source of its deliverable supply statistics and whether those statistics are readily available to the public. How these statistics are gathered may have a significant impact on overall numbers and contract liquidity.

This lack of accessibility to the Commission's data that underlie important portions of the proposed rules makes it difficult, if not impossible, for affected market participants to evaluate and meaningfully comment on significant aspects of the proposal.

2. The annual recalculation methodology is flawed because it contains a built-in bias towards lower annual limits.

Given the potentially severe consequences of violating a position limit, many traders currently build in a cushion to stay under position limits. This cushion typically may be 10% or more. As a result, assuming that no new investors enter the markets, the result will be overall lower open interest. Because the position limit levels will be reset annually by looking back at prior open interest levels, this may result in the following year having a lower position limit level and create a self-reinforcing cycle of lower open interest and lower position limits in successive years.

In addition, open interest can change dramatically from year to year depending on external events such as conflict in the Middle East or significant changes in weather that impact prices. If a slow year is followed by a more active year due to these events, the hard position limits will limit liquidity when it is most needed.

3. The Commission should provide an exemption for inter-commodity spread positions.

The Commission found it appropriate to provide for an exemption from speculative position limits for calendar spreads, presumably because such spreads reflect a relationship between two contract months rather than an outright directional trade in each component of the calendar spread. We suggest that the Commission should also provide for an exemption for intercommodity spreads, which similarly reflect a relationship between two commodities rather than an outright directional position in the spread components. For example, a market participant may purchase electricity from a producer while simultaneously selling natural gas. The participant is expressing a view as to the relative value of each commodity (given their fixed relationship—natural gas is used in the generation of electricity) while hedging its overall risk and providing liquidity to both markets.

G. Alternative Actions

MFA agrees with the Commission's goals of bolstering confidence in the market and preventing market disruptions. MFA believes, however, that the Commission should consider other approaches to achieving these goals. As a first step, the Commission should build on its recent information gathering initiatives regarding index investors and provide the public with greater transparency with respect to OTC markets related to energy futures markets through the publication of additional data.[54] For example, we

[54] The Commission began publishing a Disaggregated Commitments of Traders (Disaggregated COT) report on September 4, 2009. The Disaggregated COT report increases transparency from the legacy COT reports by separating traders into the following four categories of traders: Producer/Merchant/Processor/User; Swap

believe the public would benefit from the compilation and publication of the size of various OTC energy swap markets, the value of positions that are internally netted by swap dealers, and the volume of futures market trades that are effected by swap dealers to offset risk, among other things. More transparency tends to support price discovery and market integrity. In addition, should the Commission conclude that it lacks sufficient information about the energy markets, the implementation of aggregate position accountability levels would enable the Commission to better gather information about and monitor position concentrations. Accountability levels will not have the same negative effects as the imposition of hard speculative limits since reporting, as opposed to automatically curtailing trading, will not tend to decrease liquidity in the markets. Similarly, the Commission should re-examine the hedge exemption process and ensure that exemptions are not being used beyond their intended, legitimate purposes. The Commission should also utilize its increased information technology and data gathering capacity to support its ongoing efforts to identify and prosecute market manipulation.[55] Likewise, we would support Congress appropriating increased funds to the Commission to ensure that it has the necessary enforcement and surveillance staff resources to oversee futures markets and prosecute market manipulation and other abusive market practices, as this would achieve the Commission's objectives in the way least likely to reduce market liquidity and cause other unintended consequences.

V. CONCLUSION

Our domestic regulated futures markets play a leading role in price discovery and risk transference in both the U.S. and worldwide. We share the Commission's desire to preserve and enhance the integrity of our markets. However, we believe the Commission has not fully addressed the costs to these markets and their participants of the proposed federal limits. Such costs include reduced liquidity and a corresponding decline in the competitiveness of U.S. futures markets as business migrates overseas or to the OTC markets.

MFA is concerned that the Commission has not established the need for the proposed federal position limits and in any case overestimated their potential effectiveness. Additionally, even if such limits could be proven to be necessary or effective, unilateral imposition of aggregate position limits by the Commission on contracts traded on U.S. exchanges and trading facilities without international coordination would impair the liquidity and competitiveness of U.S. energy markets. The Commission would not achieve its goal of preserving market integrity and would only reduce the price discovery and risk shifting functions of U.S. markets.

MFA respectfully suggests that the Commission reassess its approach. Additional discussions with foreign regulators regarding a coordinated approach should also be undertaken if the Commission's goals are to be achieved. We believe that the Commission can most effectively further its goals by taking such tangible and meaningful steps as: implementing aggregate position accountability levels across economically equivalent products and all related trading venues; requiring more comprehensive reporting of positions (both exchange-traded and OTC transactions) by large traders, swap dealers and hedgers; collecting and publishing such information more frequently as part of its COT report; examining the hedge exemption process; and using the expanded data to detect and prosecute those who attempt to

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Dealers; Managed Money; and Other Reportables. This impetus for providing market transparency arises from the recommendation to disaggregate the existing "commercial" category in the Commission's September 2008 Staff Report on Commodity Swap Dealers & Index Traders.

[55] "Aggressive use of the Commission's surveillance authority in partnership with the exchanges should be sufficient to closely monitor and protest the integrity of the markets." Commissioner Sommers dissent, Notice, at 4171.

manipulate the market. MFA believes that this type of approach addresses the Commission's valid public policy concerns regarding the integrity of the futures markets, while at the same time preserves the liquidity, transparency and competitiveness of U.S. energy markets.

We would be happy to discuss our comments or any of the issues raised by the Proposed Federal Limits at greater length with the Commission or its staff. If staff has any questions, please do not hesitate to call Jennifer Han or the undersigned at (202) 367-1140.

Respectfully Submitted,

/s/ Richard H. Baker

Richard H. Baker
President and CEO

cc:

The Honorable Chairman Gary Gensler
The Honorable Commissioner Michael Dunn
The Honorable Commissioner Bart Chilton
The Honorable Commissioner Jill Sommers
The Honorable Commissioner Scott O'Malia
Mr. Stephen Sherrod, Acting Director of Surveillance, Division of Market Oversight
Mr. David P. Van Wagner, Chief Counsel, Division of Market Oversight
Mr. Donald Heitman, Senior Special Counsel, Division of Market Oversight
Mr. Bruce Fekrat, Special Counsel, Division of Market Oversight

MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK

March 28, 2011

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

David A. Stawick
Secretary
Commodity Futures Trading Commission
1155 21st Street, N.W.
Washington, D.C. 20581

Re: RIN: 3038-AD15 and 3038-AD16; Position Limits for Derivatives

Dear Mr. Stawick:

Managed Funds Association ("MFA")[1] appreciates the opportunity to comment on the Commodity Futures Trading Commission's (the "Commission") Notice of Proposed Rulemaking on Position Limits for Derivatives, which proposes to implement federal speculative position limits for futures, option, and swap contracts in or linked to certain agricultural, metals, and energy commodities (the "Proposed Rules").[2] MFA has carefully reviewed the Proposed Rules and is offering its comments to help the Commission draft final rules that balance the Commission's objectives with legitimate industry concerns.

MFA's members rely on fair, competitive, and transparent markets that respond to fundamental factors to conduct their businesses. MFA's members play a vital role in the futures markets by assuming the price risk from commercial participants (hedgers) on both the long and short sides of the market, and by providing liquidity that facilitates risk transfer and price discovery for businesses around the world. MFA's members participate directly, through investing in other financial entities, and/or by investing in operating companies and financial institutions.[3]

The Commission previously published a Notice of Proposed Rulemaking on Federal Speculative Position Limits for Referenced Energy Contracts in January 2010, which it subsequently withdrew.[4] In

[1] MFA is the voice of the global alternative investment industry. Its members are professionals in hedge funds, funds of funds, and managed futures funds, as well as industry service providers. Established in 1991, MFA is the primary source of information for policy makers and the media and the leading advocate for sound business practices and industry growth. MFA members include the vast majority of the largest hedge fund groups in the world, who manage a substantial portion of the approximately $1.9 trillion invested in absolute return strategies. MFA is headquartered in Washington, D.C., with an office in New York.

[2] 76 Fed. Reg. 4752 (Jan. 26, 2011) (the "Notice").

[3] For example, some of MFA's members invest in non-financial operating companies whose business involves the production, refining, merchandising, or processing of energy and entities engaged in the development of energy market infrastructure (such as production, transportation, or storage of energy), and thus have an interest in enabling such entities to access liquid price discovery and risk-shifting markets. MFA's members also may invest in financial institutions, whose business may involve the use of the futures markets for risk management purposes.

[4] Federal Speculative Position Limits for Referenced Energy Contracts and Associated Regulations, 75 Fed. Reg. 4144 (Jan. 26, 2010), withdrawn 75 Fed. Reg. 50950 (Aug. 18, 2010) (the "January 2010 Notice").

MFA's comment letter on the January 2010 Notice, we expressed several broad concerns about the proposed position limits, including that (i) research and experience demonstrate that position limits have not reduced price volatility or prevented market manipulation, and it was not clear how the proposed federal limits would achieve their intended purpose with respect to energy markets; (ii) proposed federal limits likely will result in decreased market liquidity, which in turn would impair the ability of commercial market participants to hedge against rising prices; (iii) restricting trading on U.S. futures markets may drive trading overseas, reducing the competitiveness of U.S. markets; (iv) the costs of the proposed federal limits far outweighed the benefits; (v) the Commission underestimated the number of affected parties, the costs to the market of compliance with the proposed rules and the potential unintended consequences; and (vi) the Commission should have considered the availability of alternative approaches. MFA also provided a number of specific comments on the January 2010 Notice, including (a) the negative effects of the proposed "crowding out" provision in the spot month; (b) the need to preserve the existing disaggregation relief for independently controlled accounts; (c) the need for greater transparency in the calculation of open interest and deliverable supply; (d) flaws in the methodology for annual recalculation of position limits; and (e) the advisability of an exemption for inter-commodity spread transactions.[5]

While MFA appreciates that the Commission has not included a "crowding out" provision in the Proposed Rules, MFA believes that many of its prior concerns with the January 2010 Notice are still applicable to the Proposed Rules.

As the Commission considers final rulemaking, we respectfully urge it to gather and examine carefully all relevant data and consider less onerous alternatives. Rulemaking relating to position limits should be empirically driven and not a response to popular sentiment or partial analyses. Unnecessary and sweeping changes to the current effective position limit framework can become a vehicle for costly, detrimental, and unintended consequences, and can severely impair the efficient functioning and competitiveness of U.S. derivatives markets. MFA concurs with the statement of Commissioner Dunn, "To date, CFTC staff has been unable to find any reliable economic analysis to support either the contention that excessive speculation is affecting the markets we regulate or that position limits will prevent excessive speculation. The task then is for the CFTC staff to determine whether position limits are appropriate. With such a lack of concrete evidence, my fear is that, at best, position limits are a cure for a disease that does not exist or at worst, a placebo for one that does."[6]

I. EXECUTIVE SUMMARY

MFA has carefully considered the Proposed Rules and is providing its comments and recommendations, which are summarized as follows:

- The Commission's proposed limits do not strike the right balance amongst the prescribed statutory goals of diminishing excessive speculation and deterring market manipulation, and ensuring sufficient market liquidity for bona fide hedgers and the price discovery function of the underlying market. Research and experience demonstrate that position limits have not reduced price volatility or prevented market manipulation. Rather, research shows that such limits may negatively impact

[5] Letter from Richard H. Baker, President and CEO, Managed Funds Association, to David A. Stawick, Secretary, Commodity Futures Trading Commission (Apr. 26, 2010) available at: http://www.managedfunds.org/downloads/MFA%20CFTC%20energy%20spec%20limits.4.26.10.pdf.

[6] Opening Statement of Commissioner Michael V. Dunn, Commodity Futures Trading Commission Open Meeting (January 13, 2011).

market liquidity and price discovery. MFA believes that the position limits proposed in the Proposed Rules will place a greater burden on interstate commerce by hindering the ability of futures markets to perform their fundamental price discovery, risk transfer, and risk management functions, which depend on the existence of liquid, fair, and competitive markets. Moreover, absent coordination with foreign regulators and boards of trade, the imposition of position limits on U.S. markets may shift liquidity to foreign markets.

- The Commission's proposed limits are a flawed cure for a problem that the Commission has not found to exist. Even if the Commission were to find excessive speculation in the commodity markets, there are several defects in the Proposed Rules. For example, the annual recalculation methodology for Commission determination of non-spot month position limits results in a bias towards lower annual limits.

- The Commission's proposed changes to the disaggregation rules will result in unnecessary aggregation of independently controlled accounts, burden investors and investment managers, and potentially reduce liquidity in U.S. futures markets. Disaggregation based upon independence of control has been a longstanding policy of the Commission and U.S. futures exchanges. This policy was adopted gradually and refined over time in a carefully considered and open process. Because the current policy is effective, the Commission's proposed changes are unnecessary and may have severe unintended consequences.

- The proposed spot-month limits on cash-settled contracts are not supported by any data that establishing such limits by reference to 25% of deliverable supply is appropriate or that further limiting the reference to a specific delivery point is justified. Alternative approaches should be considered to ensure that liquidity is not diminished in these widely-used risk management contracts.

- The Commission should restore the inter-commodity hedge and arbitrage exemptions that the Proposed Rules appear to have deleted, which are central to managing risk and maintaining balanced portfolios.

- MFA has a number of additional concerns and suggestions regarding: (i) the proposed individual class rules, which will impose costly administrative and compliance burdens; (ii) the proposed legacy position limits for agricultural commodities, which should be replaced by limits calculated in the same manner as limits for other commodity categories under the Proposed Rules; (iii) the proposed pre-existing position exemption rules, which may result in disorderly markets when the positions are liquidated and the full position cannot be rolled forward; (iv) the proposed position visibility rules, which may impose costly burdens on market participants to produce data on an ongoing basis when it is not clear that the Commission has the capacity to readily evaluate or utilize such data; (v) the proposed issuance of separate rulemaking for limits relating to significant price discovery contracts that are linked to the referenced contracts and how it will be integrated with the position limit framework of the Proposed Rules; (vi) the use of rounding in calculating position limits; and (vii) obtaining greater clarity as to the application of the proposed limits.

II. THE PROPOSED RULES

The Proposed Rules would:

A. Establish spot-month position limits for certain agricultural, metals, and energy commodities contracts (defined as "referenced contracts") initially at the levels currently imposed by designated contract markets and later at levels equal to 25% of deliverable supply, as determined by the Commission.

B. Establish aggregate (i.e., aggregating futures, options, swaps, or swaptions in each contract) spot-month position limits for referenced contracts. The spot-month position limits initially would be set at the levels currently imposed by DCMs (i.e., 25% of deliverable supply). The spot-month limits would be applied separately for physically delivered and cash-settled contracts.

C. Establish a conditional-spot month limit that will permit traders without a hedge exemption to acquire position levels in cash-settled contracts that are five times the spot-month limit if such positions are exclusively in cash settled contracts and provided that the trader: (i) for cash-settled contracts in the spot month, does not hold or control positions in cash-settled contracts in the spot month that exceed the position limit; (ii) does not hold or control positions in the physical delivery referenced contract based on the same commodity that is in such contract's spot month; (iii) holds 25 percent or less of cash or forward positions in the referenced contract's underlying physical commodity deliverable at the location specified in the futures contract in the same commodity; and (iv) has submitted a certification to the Commission.

D. Adopt six classes of non-spot-month position limits: (i) aggregate (i.e., futures class and swaps class) all-months-combined; (ii) aggregate single-month; (iii) futures class all-months-combined; (iv) futures class single-month; (v) swaps class all-months combined; and (vi) swaps class single-month. The non-spot-month position limits would be tied to a specific percentage of overall open interest for a particular referenced contract in the aggregate or on a per class basis. The non-spot position limits would be set as the sum of (i) 10% of the first 25,000 contracts; and (ii) 2.5% of open interest beyond 25,000 contracts. Under this approach, the Commission would eliminate the calendar-spread exemption within single-month limits.

E. Adopt a new, more restrictive, definition of bona fide hedging transaction for referenced contracts that requires the hedging transaction to represent cash market transactions and offset cash market risks, rather than transactions that would normally, but not necessarily, represent a substitute for cash market transactions or positions. The bona fide hedging transaction definition also includes a new swap dealer hedge exemption for swaps entered into by a dealer with counterparties wherein the swap would qualify as a bona fide hedge for the counterparty.

F. Adopt existing account aggregation standards that would require aggregation of all positions in accounts in which any trader, directly or indirectly, has an ownership or equity interest of 10 percent or greater or, by power of attorney or otherwise, controls trading. These proposed aggregation rules, however, curtail the longstanding current exemptions for positions in pools held by a pool participant and eliminate the longstanding current independent account controller exemption. The proposed aggregation rules include three exemptions from aggregation:

1. A limited exemption for positions in pools in which a participating person has an ownership of between 10% and 25%, if the person does not have control over or knowledge of the pool's trading.

2. A limited exemption for positions of futures commission merchants ("FCMs") or their separately organized affiliates in certain discretionary accounts if they maintain only minimum control over trading in the relevant account and if the trading decisions of that account are independent from the trading decisions in the FCM's other accounts.

3. A limited exemption for entities to disaggregate the positions of an independently controlled and managed trader, that is not a financial entity, in which it has an ownership or equity interest of 10% or greater, and for which it provides a description of the indicia that demonstrate independent control and management to the Commission.

Exemptions from the account aggregation requirements are no longer self-executing. Each of the above three exemptions requires an application to, and affirmative approval of, the Commission. Additionally, each exemption must be renewed on an annual basis.

G. Retain the all-months-combined position limits for enumerated agricultural commodities as an exemption from the open interest formula for calculating position limits. The single-month limit for these contracts would be increased to the same level as the legacy all-months-combined limit, with the elimination of the calendar spread exemption.

H. Establish position visibility and reporting requirements for referenced contracts other than referenced agricultural contracts (i.e., energy and metals).

I. Provide a limited exception for positions in futures or options contracts on a DCM that are in excess of the position limits at the time they are implemented. Traders would not be permitted to enter into new contracts in the same direction, but could enter into offsetting positions.

J. Provide that the aggregate position limits would apply to a trader's positions in referenced contracts executed on or subject to the rules of a foreign board of trade.

The Commission is proposing to establish the limits in two phases, which could involve multiple final regulations or different implementation dates. In the first transitional phase, the Commission is proposing to establish spot-month position limits at the levels currently imposed by DCMs. This first phase would include related provisions, such as proposed regulation 151.5, pertaining to bona fide hedging, and proposed regulation 151.7, pertaining to account aggregation standards. During the second phase, the Commission is proposing to establish single-month and all months-combined position limits and to set Commission-determined spot-month position limits.

III. COMMENTS

A. BALANCE OF STATUTORY OBJECTIVES

The Commission's proposed limits do not strike the right balance among the prescribed statutory goals of diminishing excessive speculation and deterring market manipulation and ensuring sufficient market liquidity for bona fide hedgers and the price discovery function of the underlying market.

Section 4a(a)(1) of the Commodity Exchange Act (the "Act"), as amended, sets forth the Commission's broad authority to set such position limits as the Commission finds are necessary to diminish, eliminate, or prevent such burden to interstate commerce caused by excessive speculation that causes sudden or unreasonable fluctuations or unwarranted changes in the price of such commodity. Section 737 of the Dodd-Frank Act[7] added Sections 4a(a)(2) through (7) to the Act. Section 4a(a)(2) authorizes the Commission, in accordance with the standards set forth in Section 4a(a)(1) described above, with respect to physical commodities (agricultural, metals, and energy, but not excluded

[7] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111–203, 124 Stat. 1376 (2010).

commodities such as interest rates, currencies, or stock indices) to establish limits on the amount of positions, as appropriate, other than bona fide hedge positions. The legislative history of the Dodd-Frank Act indicates that the Commission's setting of position limits is intended to be an authorized, rather than a required, action.[8] Section 4a(a)(3) of the Act specifies that if the Commission establishes the limits in Section 4a(a)(2), it must set limits on the number of positions that may be held by any person for the spot month, each other month, and the aggregate number of positions that may be held by any person for all months, to the maximum extent practicable, in its discretion: (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.[9]

Although the Dodd-Frank Act provides the Commission with discretion and does not specify what weight the Commission must give to each of the four factors above when setting limits, the Dodd-Frank Act requires the Commission to maximize to the extent practicable each of the four factors when setting limits. Congress requires balance in establishing limits, and in seeking to further one objective (e.g., preventing excessive speculation), the Commission needs to do so in a manner that does not adversely affect another objective (e.g., ensuring liquidity). MFA believes that the Commission has not struck the appropriate balance among these four criteria, but instead has focused on addressing the fear of excessive speculation and market manipulation at the expense of ensuring sufficient market liquidity and price discovery. Further, MFA believes that the Commission has not adequately considered whether the Proposed Rules will cause price discovery in the referenced commodities to shift to trading on foreign boards of trade, as required under Section 4a(a)(2)(C) of the Act.[10] The referenced contracts are global commodities that are traded worldwide; therefore, the Commission should not implement rulemaking until there is global cooperation on position limits, otherwise U.S. markets will be disadvantaged.

MFA believes that, when the Commission exercises its regulatory oversight authority, it must be cognizant of the effect of the proposed federal limits on the ability of futures markets to perform their fundamental price discovery, risk transfer, and risk management functions, which depend on the existence of liquid, fair, and competitive markets. Therefore, any proposal that would tend to adversely affect the liquidity, fairness or competitiveness of the futures markets must be carefully scrutinized. Throughout this letter, MFA suggests certain revisions to the Proposed Rules intended to better balance the statutory policy objectives and to permit the Commission to fulfill its statutory mandate to protect the integrity of the market, but in a manner that is less disruptive to the liquidity of the market and to the operations of market participants.

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[8] See S. Rept. 111-176 (Apr. 30, 2010), "This section authorizes the CFTC to establish aggregate position limits across commodity contracts listed by designated contract markets, commodity contracts traded on a foreign board of trade that provides participants located in the United States with direct access to its electronic trading and order matching system, and swap contracts that perform or affect a significant price discovery function with respect to regulated markets." (emphasis added.)

[9] Section 4a(a)(5) of the Act requires the Commission to establish limits on the amount of positions, as appropriate, other than bona fide hedge positions, that may be held by any person with respect to swaps that are economically equivalent to futures or options contracts traded on a DCM. In establishing these limits, the Commission must address similar requirements as those described in Section 4a(a)(3) described above.

[10] Section 4a(a)(2)(C) states "In establishing the limits required under subparagraph (A), the Commission shall strive to ensure that trading on foreign boards of trade in the same commodity will be subject to comparable limits and that any limits to be imposed by the Commission will not cause price discovery in the commodity to shift to trading on the foreign boards of trade."

Section 4a(a)(7) of the Act permits the Commission to exempt any person or class of person, any swap or class of swaps, any futures or option contract, or any transaction or class of transactions from any requirement it may establish under Section 4a(a)(1). Congress granted the Commission broad, essentially unlimited, discretion to exempt traders and contracts from the position limit requirements. MFA believes that, to the extent the application of position limits to a particular class of trader or contract would not further *all* of the four factors above, the Commission should use its exemptive authority to reach the appropriate balance among the four criteria.

Excessive speculation has not been the cause of sudden or unreasonable changes in the price of commodities.

MFA notes that extensive studies have been undertaken by public and private institutions around the world on the energy price volatility of 2007-2008, seeking to identify and explain the underlying factors. MFA has found that the vast majority of reputable research and commentary from a range of sources including, for example, the Commission,[11] the GAO,[12] IOSCO,[13] the IMF,[14] the UK Treasury,[15] CME,[16] The Economist,[17] academics,[18] and market participants[19] has concluded that fundamental factors of supply and demand, along with economic factors such as the decline in the U.S. dollar, were primarily responsible for price volatility. To illustrate this conclusion, between December 31, 2007 and June 30, 2008, when the NYMEX Crude Oil price rose from $96 to $140 per barrel, open interest rose from 2.5 million to 2.8 million contracts, but the commodity index investment (i.e., speculative investment) fell from 408,000 to 363,000 open long contracts. Commission staff summarized this result stating: "While the net notional value of commodity index business in NYMEX WTI crude oil increased sharply over the 6-month period ending on June 30, 2008—by about 30 percent, the actual numbers of equivalent long futures contracts declined over that same period by about 11 percent. In other words, the sharp rise in the net notional value of commodity index business in crude oil futures appears to be due to an appreciation of the value of existing investments caused by the rise in crude oil prices and not the result of more

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[11] CFTC Inter-Agency Task Force on Commodity Markets—Interim Report on Crude Oil (July 2008).

[12] GAO Briefings to the House Committee on Agriculture on Issues Involving the Use of Futures Markets to Invest in Commodity Indexes (Dec. 2008).

[13] International Organization of Securities Commission's Technical Committee (IOSCO) Final Report (Mar. 2009).

[14] IMF World Economic Outlook (Oct. 2008).

[15] HM Treasury Global Commodities: A long term vision for stable, secure and sustainable global markets (June 2008).

[16] CME Group white paper "Excessive Speculation and Position Limits in Energy Derivatives Markets," available at http://cmegroup.com/company/files/PositionLimitsWhitePaper.pdf.

[17] *Dr Evil, or drivel? The charge-sheet against commodity speculators is flimsy*, Economist, November 11, 2010 ("In fact there is little empirical evidence that investors cause more than fleeting distortions to commodity prices. The most persuasive explanation for the rises and falls of commodities is demand and supply.").

[18] Irwin, Scott. H., and Sanders, Dwight R. (2010), The Impact of Index and Swap Funds on Commodity Futures Markets: Preliminary Results, OECD Food, Agriculture and Fisheries Working Papers, No. 27, OECD Publishing.

[19] "With Better Data, Better Understanding" (Jan. 27, 2009); Lawrence Eagles, J.P. Morgan.

money flowing into commodity index trading."[20] There was no evidence to indicate that excessive speculation was to blame, as speculators were actually reducing their long positions during this period.[21]

What is often ignored are the benefits that speculators provide to the market. Speculators such as some hedge funds absorb risk from hedgers and provide liquidity to both sides of the market.[22] Producers and users rarely meet directly, given the different sizes, durations, and specifications of their needs, and instead rely on speculators to take the opposite position. In a recent study by the OECD, research found that there was a negative correlation between speculative positions and market volatility, concluding that "there is some consistent evidence that increases in trader positions are followed by lower market volatility."[23] This follows on studies by Haigh, Hranaiova and Overdahl, which found that "hedge funds [do] not affect price levels in energy futures markets, yet[…]are very important to the functioning of the market through the liquidity they provide to other participants," and by Commission staff, which observed that "hedge fund trading activity is beneficial in that it contributes to bringing in line the prices of commodity futures at different maturities."[24] The availability of speculators to take long and short positions, bring in new information, and express countervailing views, helps complete the market for hedgers, smooth out volatility, and aid in price discovery. While the term "speculator" is an age-old technical designation, it has unfortunately taken on pejorative connotation in recent years, which detracts from this important role.

Position limits, even purportedly generous ones, may impair the ability of markets to serve their essential risk shifting function, which would increase the cost of managing risk and harm hedgers, and ultimately consumers of these products. Studies have demonstrated that on prior occasions where trading by investors was restricted, such as by prohibiting futures transactions in certain commodities (Chicago onions, Berlin wheat), the result was significantly greater, and not less, price volatility.[25] Studies

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[20] CFTC Staff Report on Commodity Swap Dealers & Index Traders (Sept. 2008).

[21] *See, e.g.,* "Commodity Price and Futures Positions" (Dec. 16, 2009), Ruy Ribero, Lawrence Eagles and Nicholas von Solodkoff, J.P. Morgan; "We can safely say there is no indication in this data of the fact speculators are pushing the price of oil," Christophe Barret, global oil analyst at Credit Agricole, quoted in Energy Risk (Apr 13, 2010), available at http://www.risk.net/energy-risk/news/1600919/cftc-speculators-influence-commodity-markets; Prepared Testimony of Philip K. Verleger, Jr., Haskayne School of Management, University of Calgary, PKVerleger LLC, to Commodity Futures Trading Commission on The Role of Speculators in Setting the Price of Oil (Aug. 5, 2009); "Speculators Cleared in U.K. Oil Volatility" (July 28, 2009), *The Wall Street Journal*; and CFTC Interagency Task Force on Commodity Markets, Interim Report on Crude Oil, *supra* note 11.

[22] "The short hedgers and long investors provide liquidity for each other by using futures markets to serve their respective interests in a open, transparent and efficient manner. Liquidity will be essential to make sure each can achieve their objectives at an efficient price. Artificial limits on that liquidity should not be imposed. There are numerous ways to further the objectives of enhanced transparency and reduced systemic risk that do not involve reductions in much needed liquidity." Prepared Statement Before the Commodity Futures Trading Commission of Kevin Norrish, Managing Director of Commodities Research, Barclays Capital (March 25, 2010).

[23] Irwin, S. H. and D. R. Sanders (2010), "The Impact of Index and Swap Funds on Commodity Futures Markets: Preliminary Results", OECD Food, Agriculture and Fisheries Working Papers, No. 27, OECD Publishing. doi: 10.1787/5kmd40wl1t5f-en.

[24] See Büyükşahin, Haigh, Harris, Overdahl and Robe, Fundamentals, Trader Activity and Derivative Pricing (December 4, 2008), available at: http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/marketreportenergyfutures.pdf.

[25] "At a minimum, there is no evidence for the claim that futures markets are associated with higher price volatility. Indeed, the results presented in this paper strongly suggest the opposite: futures markets were associated with, and most likely caused lower commodity price volatility." "Populists versus theorists: Futures markets and the volatility

comparing price volatility in various commodities (wheat, cotton, oats, sugar, butter, eggs, rubber, silk, copper, silver, lead, zinc, soybeans, linseed, and hogs) before and after the establishment of futures markets for such commodities also demonstrate that futures markets are associated with lower price volatility.[26] Longstanding research, including studies conducted by the Commission, has shown that speculators and index funds perform an essential function in the commodity markets by transferring risk from commercial participants, providing liquidity, reducing volatility, and contributing to the price discovery process, which benefits hedgers and all consumers and producers of the commodities.[27] In a recent study by OECD, research found that there was a negative correlation between positions and market volatility, "there is some consistent evidence that increases in trader positions are followed by lower market volatility."[28]

MFA argues that the best available evidence discounts the theory that there is excessive speculation distorting the prices in the commodity markets. Accordingly, we believe that it would be inappropriate to adopt the Proposed Rules given the weight of the evidence and that the position limits proposed in the Proposed Rules will place a greater burden on interstate commerce by hindering the ability of futures markets to (i) ensure that the price discovery function of the underlying market is not disrupted; and (ii) perform their fundamental risk transfer and risk management functions, both of which depend on the existence of liquid, fair and competitive markets to ensure sufficient market liquidity for bona fide hedgers.[29]

The Commission's proposed limits are a flawed cure for a problem that the Commission has not found to exist.

The Commission asserts that it is not required to find that an undue burden on interstate commerce resulting from excessive speculation exists, or is likely to occur in the future, in order to impose limits. Rather the Commission states that it may impose limits prophylactically to diminish, eliminate, or prevent sudden or unreasonable price fluctuations attributable to excessive speculation.[30] Without necessarily agreeing with this interpretation, MFA believes that the prophylactic steps the Commission proposes are substantially flawed and are potentially harmful to the health of the market.

Although position limits may reduce the ability of persons with market power to squeeze or corner the market, they have been described as a crude and inefficient tool.[31] This is because it is difficult

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of prices" (June 2006), Explorations in Economic History 44 (2007) 342-362, at 357, David S. Jacks ("Jacks Study"), available at www.sciencedirect.com.

[26] Jacks Study, at 352.

[27] *See, e.g.*, "A Review of Recent Hedge Fund Participation in NYMEX Natural Gas and Crude Oil Futures Markets", New York Mercantile Exchange, Mar. 1, 2005; "Price Dynamics, Price Discovery and Large Futures Trader Interactions in the Energy Complex, Working Paper First Draft: April 28th 2005", Michael S. Haigh, Jana Hranaiova, and James A. Overdahl, Office of the Chief Economist, U.S. Commodity Futures Trading Commission ("Commission Energy Complex Report"); Testimony of Craig Pirrong, Professor of Finance, Director, Global Energy Management Institute, Bauer College of Business, The University of Houston, Before the House Committee on Agriculture (July 7, 2008) ("Pirrong Testimony"); Jacks Study at 342-362.

[28] See Irwin and Sanders, *supra* note 7.

[29] *See, e.g.,* Pirrong Testimony, at 3.

[30] 76 Fed. Reg. at 4754.

[31] Pirrong Testimony, at 5.

to set the limits at a level that inhibits market manipulation without unduly affecting the ability of markets to efficiently transfer risk. We recommend alternatives to using such a blunt instrument.

Furthermore, the annual recalculation methodology for Commission determination of non-spot month position limits, which is based on open interest, is flawed because it contains a built-in bias towards lower annual limits. Given the potentially severe consequences of violating a position limit, many traders currently build in a cushion to stay under position limits. Anecdotal evidence suggests this cushion typically may be 10% or more. As a result, assuming that no new investors enter the markets, the result will be overall lower open interest once the new position limits go into effect. Because the position limit levels will be reset annually by looking back at prior open interest levels, this may result in the following year having a lower position limit level and create a self-reinforcing cycle of lower open interest and lower position limits in successive years.

In addition, open interest can change dramatically from year to year depending on external events, such as regime change in the Middle East, significant changes in weather or economic events, that impact prices. If a slow year is followed by a more active year due to these events, the position limits will limit liquidity when it is most needed. For example, due to recent events in Egypt and Libya, open interest in NYMEX WTI has reached record levels.[32] Limits based on open interest from 2010 may limit liquidity.

The proposed federal limits are modeled after the current federal speculative position limits applicable to agricultural commodities. However, the Commission offers no empirical support for the proposition that position limits have reduced undue price volatility in agricultural commodities or will reduce volatility in energy or metals markets.[33] As Commissioner O'Malia observed, it is not clear that position limits in the agricultural markets have prevented price spikes in those markets.[34] Moreover, the Commission does not explain why the agricultural model would be correctly applied to energy and metals in view of the different characteristics that distinguish these markets. For example, the energy and metals markets are more global, energy and metals commodities are more fungible, supplies of energy and metals commodities are much greater, and energy commodities production is subject to less seasonal variation than agricultural commodities.

MFA believes that the proposed position limits, aggregation rules, and restrictive exemptions will potentially reduce liquidity in U.S. futures markets. Aside from the overall imposition of position limits, there are several other aspects of the Proposed Rules that we believe will significantly impact liquidity in the derivatives markets. Additionally, MFA questions whether the Commission's approach will promote the goal of preserving market integrity. If the imposition of position limits on U.S. futures exchanges drives more trading to other markets, the Commission will have more difficulty conducting effective market surveillance and preventing potential price manipulation in the underlying commodities.

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[32] Press Release, CME Group, CME Group Announces Three Consecutive Open Interest Volume Records in Benchmark Light Sweet Crude Oil (WTI) Futures (March 14, 2011).

[33] "[W]e do not believe a case has been made which demonstrates that prices of commodities, or other financial derivatives, can be effectively controlled through the mandatory operation of regulatory tools such as position limits, whether on exchange or OTC. Analysis of market data where position limits are already in use suggests this has not shown a reduction in volatility or absolute price movements compared to contracts where they are not." Financial Services Authority & HM Treasury, Reforming OTC Derivative Markets, A UK perspective ("FSA & HM Treasury Report") (Dec. 2009), at 34.

[34] January 2010 Notice, at 4172.

We believe there are better alternatives than position limits to deter market manipulation. Through the use of the current position reporting and market surveillance regime, and the ability to impose penalties for violations, the Commission and exchange surveillance staff can detect and prevent corners, squeezes, and other forms of manipulation. It is preferable, therefore, to use readily available market data and the Commission's statutory authority to investigate and prosecute aggressive traders that manipulate or attempt to manipulate the market, than to limit the trading activity of all other market participants through position limits. An effective enforcement regime will discourage manipulation and assure a proper balance – preventing excessive speculation and deterring market manipulation, while ensuring sufficient market liquidity and price discovery.

B. DISAGGREGATION RELIEF

The Commission's proposed limits on disaggregation relief will result in unnecessary aggregation of independently controlled accounts, burden investors and investment managers, and potentially reduce liquidity in U.S. futures markets.

The Commission has a longstanding, successful policy of disaggregation based upon independent control. There is no compelling reason to change this policy and prohibit previously eligible entities from aggregating positions.

Disaggregation based upon independence of control has been a longstanding policy of the Commission and U.S. futures exchanges.[35] The Commission historically has required aggregation of positions on the basis of ownership of positions or control of trading decisions. For this purpose, a trader holding accounts or positions in which the trader directly or indirectly has a 10% or greater ownership or equity interest generally must aggregate all such accounts or positions. Over the years, by regulation and interpretative letters, the Commission has provided relief from having to aggregate accounts or positions on the basis of ownership where discretion over trading is granted to an independent third party. The premise of such relief is that the beneficial owner in these cases does not directly or indirectly control the trading of the accounts or positions involved, and often is unaware of orders executed until a significant period of time has elapsed.

The Commission has not pointed to any problems or abuses in commodity markets arising out of the application of the current aggregation rules and exemptions permitting disaggregation that would suggest the current rule is inadequate. Indeed, the Commission states "[a]t this time, the Commission does not see sufficient justification to change its longstanding approach of considering both control and ownership in its aggregation policy. The traditional ten percent ownership standard has proven to be a

[35] *See, e.g.*, the Aggregation Policy (exemption from aggregation for futures commission merchant managed account programs utilizing independent commodity pool operators); Adoption of Commission Regulation 150.3(a)(4), 53 Fed. Reg. 415653 (Oct. 24, 1988) (extending the Aggregation Policy exemption for multi-advisor commodity funds); Exemption From Speculative Position Limits for Positions Which Have a Common Owner, But Which Are Independently Controlled, 56 Fed. Reg. 14308 (Apr. 9, 1991) (extending the exemption to commodity trading advisors); Amendment of Commission Regulation 150.3, 57 Fed. Reg. 44492 (Sept. 28, 1992) (making the exemption for eligible entities self-executing); CFTC Interpretative Letter No. 92-15 (where an FCM is one of the components of a larger organization, the Aggregation Letter exemption would apply, even where the CPO/CTA were being operated as a separate subsidiary of a common parent); Amendment of Commission Regulation 150.1(d) and 150.4, 64 Fed. Reg. 24038 (May 5, 1999) (to expand the categories of eligible entities that authorize independent account controllers to trade on their behalf to the separately organized affiliates of an eligible entity); and CFTC Regulation 150.4(c) (disaggregation for ownership by limited partners, shareholder or other pool participants). *See also* NYMEX Rule 559.E.

useful measure in conjunction with the control standard."[36] Elsewhere in the Proposed Rules, in proposing rule 151.7, the Commission states that "allowing traders to establish a series of positions each near a proposed position limit, without aggregation, may not be appropriate."[37] MFA agrees with the Commission that if such traders were trading in concert or were not truly independent, then aggregation would be appropriate. In fact, the current aggregation rules would prohibit such behavior.

The Current Independent Account Controller Exemption Should Not be Narrowed.

Under current Commission Rule 150.3(a)(4), a commodity pool operator ("CPO"), commodity trading advisor ("CTA"), bank or trust company, an insurance company, or the operator of a trading vehicle that is excluded or has qualified for an exemption under Commission Regulation 4.5 (each, an "eligible entity") need not aggregate positions carried for it by an "independent account controller"[38] except in the spot month if there is a spot month limit. If an independent account controller is affiliated with the eligible entity or another independent account controller trading on behalf of the eligible entity, each of the affiliated entities must: (i) maintain written procedures to preclude them from having knowledge of, or gaining access to, trades of the other, including document and order routing arrangements or separate physical locations; (ii) trade such accounts pursuant to separately developed and independent trading systems; (iii) market such trading systems separately; and (iv) solicit such funds by using separate disclosure documents (where such documents are required under Commission rules).

Proposed Rule 151.7 eliminates the current independent account controller exemption. In its place, the Commission adds a limited disaggregation exemption for an entity that owns 10% or more of a non-financial entity whose trading is managed by an independently controlled and managed trader that can demonstrate independent control and management.

The elimination of the independent account controller exemption would eliminate the ability of firms to disaggregate different parts of their business or different passive accounts that follow different investment strategies (unless it qualifies for the owned non-financial entity exemption). For example, an asset manager now may legitimately access multiple active and passive trading programs that are independently managed by independent account controllers. Some programs involve short-term trading strategies, some are long-term, some are based on market fundamentals and some are based on technical signals. Asset managers also may invest through separate accounts or "funds of funds" structures which allow their investors to have access to various and diversified independently managed investment strategies. An asset management firm also may own, in whole or in part, or through private equity investments, utilities, producers of energy, or other energy and energy-related companies, and need to hedge those exposures independently from other trading strategies. The ability to invest in a variety of strategies and obtain access to a variety of independent managers is particularly important to larger passive investors, such as pension plans.

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[36] 76 Fed. Reg. at 4756.

[37] 76 Fed. Reg. at 4762.

[38] For this purpose an independent account controller is defined as a person who: trades independently on behalf of an "eligible entity" such as a CPO or CTA; over whose trading the CPO or CTA maintains only such minimum control consistent with its duty to supervise diligently the trading done on its behalf; who has no knowledge of any trading decisions by any other independent account controller acting on its behalf; and who is separately registered as a CTA or an associated person of a CTA. Commission Regulation 150.1(d).

The Commission has given no reason to depart from its longstanding exception for independently controlled accounts from its aggregation policy.[39] By preventing asset managers from disaggregating independent account controllers for purposes of position limits, asset managers and/or independent account controllers to whom they allocate assets may be compelled to reduce their participation in the futures markets, and/or shift their business to other venues, resulting in a reduction of market liquidity on U.S. futures exchanges. We also note that the Proposed Rules would effectively require otherwise independent trading operations of commonly owned enterprises to communicate with each other as to their trading positions and intentions so as to avoid violating position limits. A trader, such as a pension plan, also would be required to signal to its independent managers the positions of its other independent managers to ensure that the trader does not exceed the position limits. Such communications would raise confidentiality issues and the potential for trading in concert, which is precisely the sort of behavior that the Proposed Rules seek to avoid.

In proposing this new exemption, the Commission acknowledges the comments to the January 2010 Notice that the removal of the independent account controller exemption would force aggregation in situations where meaningful control, management, and information barriers demonstrated sufficient independence to warrant disaggregation. The Commission states that the Proposed Rules "address the concern of not having an independent account controller exemption by establishing the owned non-financial entity exemption."[40] While MFA appreciates the Commission's attempt to alleviate this concern, we believe that this proposed non-financial entity exemption is too narrow to provide meaningful relief for market participants.

MFA believes that asset managers and corporate enterprises should be free to allocate capital efficiently across all types of business lines (including speculative trading ventures and commercial enterprises - both financial and non-financial) and independent managers without fear that this independent trading will be subject to aggregated position limits, possibly affecting their ability to participate in a given market.

MFA also believes that the current disaggregation rules generally have been successful in preventing a single trader that has control over multiple accounts from establishing positions in excess of position limits, while at the same time affording investors the opportunity to gain exposure to diverse trading strategies employed by various independent managers without the fear of being deemed to be trading in concert with such managers. In instances where the Commission has found that a trader violated position limits because its positions should have been aggregated, the Commission has been able to address aggregation in the enforcement action.[41] A fair, effective and rigorous enforcement program will discourage future violations.

Furthermore, the Commission has not provided any explanation of its rationale for treating financial entities differently from non-financial entities. A financial entity should be able to qualify for this exclusion if it operates with enumerated separation of functions and risk management procedures. If the Commission is concerned that the information barriers constructed between commonly owned enterprises are inadequate for the purposes of maintaining true independence among account controllers, the appropriate regulatory response would be to audit for the adequacy of, and compliance with, such

[39] Statement of Aggregation Policy and Adoption of Related Reporting Rules, 44 Fed. Reg. 33839 (June 13, 1979) (the "Aggregation Policy").

[40] 76 Fed. Reg. at 4756.

[41] See, e.g., In re Andrew W. Daniels, CFTC Docket No. 11-05 (Jan. 26, 2011) and In re Dairy Farmers of America, Inc., CFTC Docket No. 09-02 (Dec. 15, 2008).

information barrier policies and procedures, and then take action to correct any deficiencies found, rather than to automatically require aggregation.

The Commission should not curtail the pool participant exemption.

Under Commission Rule 150.4(b), a trader who is a limited partner or shareholder in a commodity pool (other than the pool's CPO) with an ownership or equity interest of 10% or more in the pool generally need not aggregate the pool's positions so long as such trader does not control the trading of such pool. Moreover, under Commission Regulation 150.4(c)(2) if the trader who is a limited partner or shareholder with an equity or ownership interest of 10% or greater in the pool is an affiliate of the pool's CPO, the trader need not aggregate the pool's positions, provided that: (i) the pool's CPO maintains written procedures to preclude the trader from having knowledge of, or gaining access to, the pool's trading or positions; (ii) the trader does not have direct, day-to-day supervisory authority or control over the pool's trading decisions; and (iii) if the trader is a principal of the pool's CPO, the trader maintains only such minimum control consistent with its responsibilities as a principal and its duty to supervise the pool's trading activities.[42]

Under Proposed Rule 151.7, the position limits in referenced contracts would apply to all positions in accounts in which any trader, directly or indirectly, has an ownership or equity interest of 10 percent or greater or, by power of attorney or otherwise, controls trading. Proposed Rule 151.7 contains a limited exemption for positions in pools in which a participating person has an ownership interest of between 10% and 25%, if the person does not have control over or knowledge of the pool's trading. Under the Proposed Rules, there is no possibility for disaggregation if ownership reaches 25%, whereas under the current rules, this would apply only if the pool operator was exempt from registration under Commission Rule 4.13 and relief under the independent account controller exemption for nonspot month positions is not applicable.

One of the Commission's goals in implementing position limits is the prevention of concentration of large positions in one or a few traders' accounts, which may create the unwarranted appearance of liquidity and market depth, which, in fact, may not exist.[43] The Commission states that "[p]osition limits address these risks through ensuring the participation of a minimum number of traders that are independent of each other and have different trading objectives and strategies."[44] By aggregating independent traders, rather than allowing them to trade independently, the Commission is increasing concentration that will result in more limited investment opportunities, burden investors and investment managers, and potentially reduce liquidity in U.S. futures markets.

The monitoring of ownership percentages of investors in a commodity pool is burdensome, difficult to manage, and creates a potential trap for investors who may unintentionally violate limits. Many commodity pools offer investors the opportunity to contribute capital and make withdrawals on a quarterly or monthly basis, and in some instances, more frequently. Withdrawals from a commodity pool generally require advance notice. An investor would need to constantly monitor its ownership percentage in the commodity pool to determine whether or not aggregation was required. For example, if a pension plan investor in a commodity pool has a 20% percentage interest in the commodity pool, and another

[42] Additionally, Commission staff has provided no-action relief from having to aggregate positions on the basis of taking a 10% or greater ownership or equity interest in another entity on a case-by-case basis, where, among other things, trading is conducted separately and independently by or on behalf of the two affiliated entities.

[43] 76 Fed. Reg. at 4755.

[44] 76 Fed. Reg. at 4755.

investor makes a substantial withdrawal, such that the pension plan's percentage interest increases to 30%, it will need to aggregate the commodity pool's positions, without the possibility of an exemption. It may request a withdrawal from the commodity pool, but would be required to aggregate its positions until the withdrawal became effective. As a result, the pension plan, who has no investment discretion and whose investment in the commodity pool has not changed, could unwittingly violate position limits due to the required aggregation. The effect would be to severely limit the pension plan's ability to diversify its allocations and meet its plan obligations. This also could limit the ability of pool operators to launch new commodity pools, as pool operators will need to attract more seed investors to alleviate concerns that any initial investor will exceed 25% ownership.

By the same token, an investor in a pool that is required to monitor and aggregate its positions with a commodity pool typically will not be able to obtain the commodity pool's position information on a real-time basis. Also, since such an investor has no investment discretion, it will not be able to cause the commodity pool to reduce its positions to cause the investor to be in compliance with the position limits. For example, an investor, such as a university endowment, that owns a 30% interest in each of two commodity pools, with no investment discretion in either pool, could be in violation of the position limits if the managers of each pool, on their own initiative, take large positions in a referenced contract. The investor likely will not know that its aggregate position violates the position limits and will have no ability to cause the commodity pools to reduce their respective positions. Even if the investor did become aware of the large positions, the investor may not be able to redeem its interest in the commodity pool due to the commodity pool's liquidity provisions. Assuming that the investor was aware of the large positions, and was able to redeem its interests, MFA believes that a passive investor in a commodity pool should be permitted to retain its interests because the trader's ability to harm or manipulate the market is limited by its lack of investment control.

An application, approval and annual renewal based exemption to the aggregation requirements is unnecessary and inconsistent with the normal operation of traders.

The change from a self-executing disaggregation exemption to an application and approval-based exemption, with an annual renewal application and approval, from the aggregation requirements creates an additional burden on traders and the Commission without any tangible benefit. The application rules would require a trader to file an application to be exempt from the disaggregation requirements no later than 9:00 am on the business day following the reporting obligation.[45] The Commission estimates that the proposed reporting requirements would affect 60 entities and result in a total burden of 300,000 labor hours. This results in an estimate of an astonishing 5,000 labor hours per filing.[46] In the event a trader determined it had exceeded the position limits but was entitled to disaggregate its positions, it would simply be impossible for a trader to prepare and complete the filing before 9:00 am on the next business day. Further, as described above, because of a lack of position visibility or account control, many passive traders may not know that they had violated the position limits until after the filing deadline. This may lead to many prudent traders filing anticipatory exemption applications and annual renewals, regardless of whether they will ever need to rely on the exemptions.

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[45] MFA notes that the timing of the filing requirement is not clear from the proposed rules; however, for purposes of this comment letter, MFA is assuming that the Commission intended §151.10(b) to apply to the filing of an exemption.

[46] 76 Fed. Reg. at 4766. MFA believes that this may be a typographical error; however, its comments remain relevant even if the correct estimate of the reporting burden is significantly less.

The Commission states that "the self-executing nature of the exemptions creates an insufficient and inefficient verification regime and ultimately diminishes the Commission's ability to properly perform its market surveillance responsibilities." MFA believes that the Commission has historically done an excellent job of performing its market surveillance responsibilities under the existing rules. The Commission does not describe why the current system is insufficient and inefficient, and cites no evidence of abuse of the existing self-executing exemptive procedure. Nor does the Commission cite to any instances where additional information about account controllers would have enabled it to act more expeditiously or effectively in fulfilling its market surveillance responsibilities. Nor does the Commission explain why an annual renewal of this exemption would enhance the Commission's ability to perform market surveillance.

As we describe below, the answer is not for Commission staff to spend its limited resources reviewing exemption applications and annual renewals, but rather, the Commission should dedicate those valuable resources to surveillance, audit and enforcement as it has successfully done to date. Instead of requiring an application for exemptive relief and annual renewals, the Commission could require independent account controllers to file a notice informing the Commission that they are availing themselves of the exemption and a representation that they meet the relevant standards. The Commission should require that this notice be filed on an annual basis and remain effective until withdrawn by the trader. Then through its surveillance function, the Commission could audit any entities or account controllers whose activity raises a specific aggregation concern.

If, for example, the Commission is concerned that the information barriers between commonly owned enterprises are inadequate, an appropriate regulatory response would be to audit for the adequacy of, and compliance with, such information barrier policies and procedures, rather than to automatically require aggregation with no opportunity for relief. The Commission already has access to information regarding cross-ownership of traders through its Statement of Reporting Trader forms and may use this information to cross-reference trade information to determine if an examination of the account controller's independence is warranted.

C. SPOT-MONTH LIMITS ON CASH-SETTLED CONTRACTS

Although limits on spot-month levels at 25% of deliverable supply is an historical level for physically-delivered contracts, the Commission does not justify its application of this level to cash-settled contracts. Additionally, the Commission does not explain its constraint of calculating deliverable supply to a given delivery point. Furthermore, the Commission does not provide any quantitative or economic analysis as to why the conditional limit for cash-settled contracts should only be five times the spot-month limit.

While MFA agrees that deliverable supply is an appropriate basis for setting limits on physically-settled contracts, which involve the making and taking of delivery and impact a commodity's settlement price, we do not believe that the same is true for cash-settled contracts. Imposing equal levels for each contract type presupposes they are fungible contracts, which they are not, and may result in unnecessarily constraining legitimate risk management activity with the cash-settled contract in the spot month. We would urge the Commission to consider alternative approaches, including applying the aggregate limit to cash-settled contracts instead.

Even if the Commission determines that a limit for cash-settled contracts based off of deliverable supply is necessary, tying the overall calculation to a given delivery point in all cases is misguided. Certain benchmark contracts, such as the NYMEX Henry Hub Natural Gas contract, are widely used by a range of commercial hedgers to manage their risks. In many instances, the hedger has no intention of making or taking delivery at the Henry Hub, but rather uses the cash-settled contract for its superior liquidity and price discovery to hedge risks in other locations or for other commodities with significant natural gas inputs. By limiting the calculation of deliverable supply only to this one point in Erath, Louisiana, however, the Commission would be ignoring this sizeable activity and arrive at a number far too low to accommodate it. These dynamics may vary by asset class, commodity, and contract type, and the Commission should give due consideration to these factors in devising its limits methodology rather than taking a one-size fits all approach.

Finally, and in related fashion, the conditional cash-settled limit of five times the spot month limit for those not holding any physically-settled contracts appears to be arbitrary and likely insufficient. The Commission provides no indication as to how it arrived at this figure or that it strikes the right balance between supporting liquidity and diminishing undue burdens. We note that since the CME adopted similar rules for its NYMEX cash-settled natural gas futures contract in February 2010, early analysis has shown that the closing range on the last day of trading of the physically-delivered contract has widened, which suggests that the new rule has resulted in greater price volatility on the last day of trading. Taken into consideration with the potentially low deliverable supply calculation described above, the conditional limit could have an even less cushioning effect for contracts and markets that historically have seen greater activity during this period. As before, we respectfully suggest that the Commission consider the dynamics of individual spot month markets before making a limit determination and ensure that the calculations are responsive and not overly rigid. While five times may suffice for certain commodities, it may be insufficient and disruptive in others.

D. INTER-COMMODITY SPREAD EXEMPTION

The Commission should include an inter-commodity spread and arbitrage exemption, which currently appears in exchange rules, to allow for legitimate trading practices that promote risk reduction.

The Commission should use its statutory authority in Section 4a(a)(7) to permit an exemption for inter-commodity spread and arbitrage transactions. Pursuant to existing rule 150.5, exchange rules currently contemplate the availability of an exemption for inter-commodity spread and arbitrage transactions,[47] but no analogous exemption has been included in the Proposed Rules. The Commission should provide for an exemption for intercommodity spreads, which reflect a relationship between two commodities rather than an outright directional position in the spread components. For example, a market participant may purchase electricity from a producer while simultaneously selling natural gas. The participant is expressing a view as to the relative value of each commodity (given their fixed relationship – natural gas is used in the generation of electricity) while hedging its overall risk and providing liquidity to both markets. Exemptions have historically recognized the flattening out of this risk by counting only the net amount toward one's position size. Arbitrage and inter-commodity spreads do not raise the same price volatility concerns as outright positions. On the contrary, they constitute a standard investment practice that minimizes exposure while capturing inefficiencies in an established relationship and aiding price discovery in each contract. Eliminating inter-commodity exemptions will inhibit such efficiency, particularly given the lack of single contracts that perform the same function.

[47] See Chicago Mercantile Exchange Rule 559.C.

E. ADDITIONAL CONCERNS AND SUGGESTIONS

1. The Commission's proposed class limits rules in the non-spot months impose costly administrative and compliance burdens.

The proposed class limits would apply across classes (e.g., futures class and swaps class) and would apply single-month and all-months combined to each class individually. The Commission's rationale for class limits is to ensure market power is not concentrated in any submarket and that a trader is not holding excessively large, but offsetting positions in any one submarket. However, separate class limits are inconsistent with the Commission's premise underlying aggregate limits, i.e., that swap and futures markets are essentially a single market. The perceived benefits from the class limits rules could be achieved in a less burdensome manner, for example, through market surveillance of large trader data. Additionally, the Commission has conceded that it requires additional, reliable, and verifiable data to enforce the non-spot month limits.[48] The Commission should wait until it has collected and evaluated data regarding open interest in the futures and swap markets before determining whether class limits provide any additional benefit. It is premature for the Commission to establish a class limit framework in the absence of objective, quantitative market data.

2. Limits based on an annual calculation of estimated deliverable supply may not adequately take into account seasonal fluctuations or trends in volume.

The Proposed Rules would require each DCM that lists a referenced contract to submit to the Commission an estimate of deliverable supply on an annual basis. The Commission would consider the DCM's estimate in conjunction with analyzing its own data to make a final determination of deliverable supply. MFA is concerned that this approach may not take into account seasonal fluctuation that may exist in some of the referenced commodities, resulting in periods where the position limits are too low to permit effective risk management. MFA also is concerned that resetting limits only on an annual basis may not adequately address spikes in demand or deliverable supply that may occur during the course of the year. MFA urges the Commission to consider whether the annual re-calculation of annual limits should be based upon the peak seasonal deliverable supply in the prior year, or whether it would be appropriate, with respect to certain referenced contracts, to provide for adjustments to limits more frequently than just once a year. Because different commodities have different seasonality and react to different market fundamentals, a single approach may not work for all types of referenced contracts, and the Commission may wish to consider a more flexible approach.

3. There should be no legacy position limits for agricultural contracts, rather such contracts should be subject to the same limits as other commodities under the Proposed Rules.

In the Proposed Rules, the Commission determined that extending Commission-set position limits beyond agricultural products to metals and energy commodities would create a "uniform approach would also encourage better risk management and could reduce systemic risk."[49] However, by proposing legacy limits that would retain current all-months combined limits for certain agricultural contracts, the Commission has not adopted a uniform approach.[50] Moreover, since these limits were originally set in 2004, at a time when open interest levels were much smaller, they do not reflect current market activity

[48] 76 Fed. Reg. at 4759.

[49] 76 Fed. Reg. at 4755.

[50] CBOT: Corn and Mini-Corn, Oats, Soybeans and Mini-Soybeans, Wheat and Mini-Wheat, Soybean Oil, Soybean Meal; MGE: Hard Red Spring Wheat; NYBOT (ICE): Cotton No. 2; KCBOT: Hard Winter Wheat.

and should be updated. Indeed, if they were adjusted to reflect today's size, wheat limits would rise by 144% and corn by 108%.[51] For this reason and for the sake of efficiency, if the Commission ultimately decides to impose limits across all 28 commodities, MFA believes that legacy levels should be abandoned in favor of the new levels.

4. The proposed pre-existing position exemption may have unintended harmful consequences.

The Proposed Rules provide a limited exception for positions in futures or options contracts on a derivatives contract market that are in excess of the position limits at the time they are implemented. Traders would not be permitted to enter into new contracts in the same direction, but could enter into offsetting positions. MFA has concerns about the implementation of this exemption. For example, an index fund manager who has established and carries a pre-existing position in excess of the proposed new limits and desires to roll its positions into a subsequent month will have to trade naked out of that portion of its position that exceeds the new limits. Since the index fund positions (and often, the timing of the roll) generally are known to the market, other traders may take undue advantage of the index fund when it rolls its positions, and/or the liquidation of the excess position could be disruptive to the market. If the Commission moves forward with the proposed limits, it should permit a six-month phase-out period for pre-existing positions and allow managers to roll pre-existing positions into the next month, despite the fact that they may exceed the new position limits.

5. The Commission should clarify its intentions for rulemaking relating to limits for significant price discovery contracts.

MFA requests that the Commission clarify its intentions with respect to its proposal to issue a separate rulemaking for limits relating to significant price discovery contracts that are linked to the referenced contracts.[52] MFA would like to understand how such limits may interact with the aggregate and class limits set forth in this Proposed Rulemaking. For example, does the Commission intend to include significant price discovery contracts in the class limits? MFA believes that a better understanding of how such limits may interact is critical to providing complete and meaningful feedback on the Proposed Rules.

6. The Commission should clarify the use of rounding in determining limits - no ***rounding should apply to trader's positions.***

Section 151.4(g) states that "[i]n determining or calculating all levels and limits under this section, a resulting number shall be rounded up to the nearest hundred contracts." The Commission should clarify that the use of rounding applies to the calculation methodology used by the Commission to compute position limits levels, and not to the computation of positions held by traders. In other words, the rounding rule should not result in a trader that holds 501 contracts being deemed to hold 600 contracts for the purpose of complying with the position limits.

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[51] See Roberta Rampton, *Analysis: Crunch time for U.S. commodity speculation crack-down*, Reuters, March 23, 2011, available at: http://www.reuters.com/article/2011/03/23/us-financial-regulation-limits-idUSTRE72M13E20110323

[52] 76 Fed. Reg. at 4753, n. 8.

7. The Commission should provide guidance as to the application of the Proposed Rule by illustrating the application of the rules to a hypothetical portfolio.

MFA believes that certain aspects of the proposed position limit rules may be subject to differing interpretations and/or uncertainty in application, and believes that a worked-example illustrating the application of the proposed position limit rules would be useful. To that end, MFA is attaching as Exhibit A, a series of hypothetical portfolios of speculative positions in Henry Hub natural gas that is designed to assist MFA members and other market participants in better understanding: (i) netting and aggregation of instruments within an exchange, across exchanges, and across instrument types; (ii) treatment of physical vs. financial contracts; (iii) treatment of cleared vs. non-cleared bilateral contracts; (iv) limits for front month vs. deferred month positions; (v) calculation of open interest; and (vi) treatment of classes of contracts (futures + options, swaps). For each portfolio, MFA believes that it would be useful for the Commission to specify: (a) the set of limits applicable to the position; (b) how the position is allocated to each applicable limit; (c) the formula for determining each limit; and (d) the outcome of the allocation of each limit to the portion of each position to which it applies.

IV. CONCLUSION

Our domestic regulated futures markets play a leading role in price discovery and risk transference in the U.S. and globally. We share the Commission's desire to preserve and enhance the integrity of our markets. However, we believe the Commission has not struck the appropriate balance between diminishing speculation and preventing market manipulation, and ensuring sufficient market liquidity for bona fide hedgers and ensuring that the price discovery function of the underlying market is not disrupted. The Commission has not fully addressed the costs to the markets and their participants of the proposed federal limits, particularly the potential for reduced liquidity and a corresponding decline in the competitiveness of U.S. futures markets as business migrates overseas.[53] MFA agrees with the sentiment of Commissioner Sommers that driving business overseas is a concern that remains unaddressed by the Proposed Rules.[54]

While MFA acknowledges that the Commission is following a congressional mandate to propose and adopt rules establishing position limits, MFA respectfully suggests it consider the full weight of the statutory qualification "as needed" and only make such modifications to the current position limit framework as are absolutely necessary. In several instances, the Commission has proposed seemingly slight modifications to existing rules that in fact will have a huge impact on participants and the markets. MFA suggests that in instances where the current rules have proven to operate properly, such as the existing aggregation rules and disaggregation exemptions, and the bona fide hedge exemption, the Commission should leave them unchanged.

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[53] MFA notes that Section 719 of the Dodd-Frank Act requires the Commission, in consultation with DCMs, to conduct a study on the effects (if any) of the position limits on excessive speculation and on the movement of transactions from exchanges in the U.S. to trading volumes outside the U.S.

[54] Opening Statement of Commissioner Jill E. Sommers, Commodity Futures Trading Commission Open Meeting (January 13, 2011) ("Section 737 of Dodd-Frank states that the Commission shall strive to ensure that position limits will not cause price discovery in the commodity to shift to trading on foreign boards of trade. This proposal does not contain any analysis of how the proposal attempts to accomplish this goal. In fact, the proposal does not even mention this goal. Driving business overseas is a long standing concern of mine, and that concern remains unaddressed.")

We would be happy to discuss our comments or any of the issues raised by the Proposed Rules at greater length with the Commission or its staff. If staff has any questions, please do not hesitate to call Stuart J. Kaswell or the undersigned at (202) 730-2600.

Respectfully submitted,

/s/ Richard H. Baker

Richard H. Baker
President and CEO

cc:

Chairman Gary Gensler
Commissioner Michael Dunn
Commissioner Bart Chilton
Commissioner Jill Sommers
Commissioner Scott O'Malia
Stephen Sherrod, Acting Deputy Director, Market Surveillance, Division of Market Oversight
Bruce Fekrat, Senior Special Counsel, Office of the Director, Division of Market Oversight

Exhibit A

The following tables illustrate a series of hypothetical portfolios of speculative positions in Henry Hub Natural Gas contracts.

FOR SPOT MONTH LIMITS

	HH Natural Gas (All positions are speculative front-month)					
	Portfolio 1	Portfolio 2	Portfolio 3	Portfolio 4	Portfolio 5	Portfolio 6
ICE CLEARED:						
Last Day Swaps	500	500	500	500	1500	1500
Penultimate Swaps	500	500	500	500	-1400	-1400
Options (delta)	500	500	500	500	500	500
NYMEX CLEARED:						
Last Day Swaps	500	500	500	500	-1700	-1700
Penultimate Swaps	500	500	500	500	1400	1400
Financial Options (delta)	500	500	500	500	-500	-500
Financial Cal Spread Options (delta)	0	0	0	0	-500	-500
Physical Cal Spread Options (delta)	0	0	0	0	250	250
Physical Options (delta)	0	250	0	0	-500	-500
Futures	250	0	0	0	250	250
BILATERAL:						
Swaps	0	0	0	3000	0	-700

FOR NON-SPOT-MONTH LIMITS

	Jan-2012 HH Natural Gas (All positions are speculative)							
	Portfolio 1	Portfolio 2	Portfolio 3	Portfolio 4	Portfolio 5	Portfolio 6	Portfolio 7	Portfolio 8
ICE CLEARED:								
Last Day Swaps	3800	3800	3800	0	0	3800	3000	-3000
Penultimate Swaps	500	500	500	0	0	500	-2800	3800
Options (delta)	500	500	0	0	0	500	1000	-2000
NYMEX CLEARED:								
Last Day Swaps	3800	0	0	3800	3800	3800	-3400	-3400
Penultimate Swaps	500	0	0	500	900	900	2800	3800
Financial Options (delta)	500	0	0	500	0	0	-1000	-1000
Financial Cal Spread Options (delta)	0	0	0	0	0	0	-1000	-2000
Physical Cal Spread Options (delta)	0	0	0	0	0	0	500	500
Physical Options (delta)	0	0	0	500	500	500	-1000	-2000
Futures	0	0	0	3800	3800	3800	500	-2000
BILATERAL:								
Swaps	0	0	0	0	0	15000	0	-4000

Alternative Investment Management Association

David A. Stawick,
Secretary of the Commission,
Commodity Futures Trading Commission,
Three Lafayette Centre,
1155 21st Street, NW.,
Washington, DC 20581

Submitted via http://comments.cftc.gov

28 March 2011

Dear Mr Stawick,

CFTC request for comment on Position Limits for Derivatives

The Alternative Investment Management Association (AIMA)[1] appreciates the opportunity to provide comment on the Commodity Futures Trading Commission's (the 'Commission') request for comments on the proposed position limits for 28 core physical-delivery contracts and their "economically equivalent" derivatives. The proposed rules aim to implement section 737 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the 'Dodd-Frank Act'), which amendments section 4a(a) of the Commodity Exchange Act (the 'CEA') and requires the Commission to set position limits in line with that section.

Introduction

AIMA members are active participants in the US commodity markets, and invest for a number of reasons, including as an uncorrelated hedge to investments in other markets on behalf of their investors. They play a role providing liquidity to the market to aid price discovery, and act as willing buyers for producers and willing sellers for end users. We believe that participation of financial institutions in the commodity markets, including the derivatives market, is a genuine and useful market activity and that there is little evidence that their activities have caused additional volatility in the markets or have caused higher prices. Commodity markets, like other markets, determine their prices via the supply and demand mechanism, and where examples exist of increasing prices and volatility these can usually be linked to underlying factors such as the success of an agricultural crop, the discovery of new mineral wealth or new demand from emerging nations.

We note however that Congress has made a decision to place certain limits on trading in the commodity markets, and therefore we are keen to work with the Commission to ensure that position limits are effective but still, where possible, allow the commodity markets to function and determine accurate prices. To the extent that the Commission's proposals aim to address market abuse or market manipulation in any form, we give our full support to the Commission in this regard. For genuine market activity, the Commission must ensure that position limits are set and defined in such a way as to ensure that markets remain efficient, liquid and transparent, governed by supply and demand, and produce a fair settlement price. To this end, we would encourage the Commission to consider the discretion it is provided under section 737 to establish specific position limits only where they are "appropriate" to meet the goals of this section. If specific limits are considered appropriate the Commission should introduce such limits when it has available market data to set the limit. Where possible, it is also important that position limit levels are coordinated with the Commission's

[1] AIMA is the trade body for the hedge fund industry globally; our membership represents all constituencies within the sector – including hedge fund managers, fund of hedge funds managers, prime brokers, fund administrators, accountants and lawyers. Our membership comprises over 1,100 corporate bodies in over 40 countries, with 11% based in the US and over 30% of AIMA members' total assets under management (AUM) managed by US investment advisers.

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international counterparts, including those in Europe and Asia, to accomplish the goal as stated at section 737 "that any limits to be imposed by the Commission will not cause price discovery in the commodity to shift to trading on the foreign boards of trade".

AIMA believes the Commission has taken a generally sensible approach to implementing the position limits but we wish to raise certain issue and seek certain clarifications, particularly in relation to aggregation of traders' positions, that will ensure that the proposed rules are consistent, fair and are easy to comply with, without unintended consequences for market users.

AIMA's detailed comments

Spot-Month Position Limits

The Commission proposes to set an aggregated spot-month positions limit that is 25% of the established deliverable supply, with possible adjustments to the limit thereafter. The limit is appropriate in light of its long standing use as a limit for designated contract market (DCM) spot-month position limits. However, we believe this limit should be kept under review to ensure the limit remains appropriate and effective to prevent 'corners and squeezes' at settlement. The limit would be applicable regardless of the form that the contract takes or the venue of execution, which we accept is necessary and avoids complicating the limits via requiring separate limits for listed and unlisted trades.

As one of the goals of the limits is to ensure there is not unnecessary 'congestion' surrounding a contract in the delivery month, which causes its price to increase significantly before settlement, we believe looking at limits for physically-settled and cash-settled contracts is important. Positions taken in physically-settled contracts will have a direct impact on the market price of the underlying commodity. Cash-settled contracts will have a less direct effect and thus we agree that it is beneficial to have a limit multiple times that of the physically-settled contract to deter market manipulation or for the Commission to consider whether the limits for cash-settled contracts are appropriate at all. The direct effect that cash-settled derivatives may have on price discovery is uncertain and we would encourage the Commission to place initial cash-settled contract position limits at a higher level (beyond the proposed five times spot-month limits), to study the effects of cash-settled contracts and then lower the limits over time if thought necessary. This method would ensure that market liquidity and price discovery are not affected whilst a correct limit level may be found.

AIMA supports the increased position limits for cash-settled contracts under the conditional-spot-month position limit. Nevertheless, we are concerned about the conditions that must be fulfilled before the higher limit may be used. The conditions are such that the trader may have the five times spot-month limit only where they, among other criteria, do not hold or control any positions in physically-delivered contracts referencing the same commodity. AIMA is concerned that this approach will result in parties being prohibited from holding physically deliverable contracts, and that this will in turn cause a large reduction in liquidity in the physically-delivered market. Reduction of liquidity will have the effect of causing physically-delivered contracts to become more susceptible to movements in price, which the position limits are, in part, designed to guard against. This rule seems to have some potentially serious negative effects on the physically-delivered market, but without any corresponding benefit that could justify the approach. The rule further seems strange in that one of the other conditions of the conditional limit is that the trader may hold up to 25% of the physical commodity itself. A further effect may therefore be that investors will migrate to the physical commodity markets themselves resulting in greater price pressure in the physical commodity. If the Commissions' concern is that holding large cash-settled positions at the same time as holding physically-settled positions may provide opportunities for inter-market manipulation, we believe that the Commission should instead tackle this via market surveillance and anti-market manipulation rules, rather than as a condition on the conditional-spot-month position limits.

If the goal of the limits is ensuring efficient price discovery on a particular commodity, then it would seem unnecessary to have separate limits for commodities which would have a delivery at a different location. The price of a commodity at one delivery location will have an important bearing on the price of a commodity at a different location. An important consideration for the Commission is to ensure that it is able to effectively

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determine an accurate estimate of deliverable supply. We agree that the Commission should use the estimates as provided by the DCMs in the first stage of the implementation. Where further information is made available to the Commission by the implementation of the second stage, the method by which it will determine its own estimates of supply must be made clear to allow longer term planning by market users who will need to be able to think about their future positions in relation to possible future limits. The Commission should rely on the DCM estimates wherever possible in this regard, as the DCMs have developed sufficient experience in this regard over time. When the Commission deems it appropriate to provide its own estimates, these should be based on an estimate of the supply which is genuinely possible to be delivered and which would contribute to the price discovery mechanism. This may include all supplies available in the market at all prices and at all locations, as if a party were seeking to buy a commodity in the market these factors would be relevant to the price.

Non-Spot-Month Position Limits

Although AIMA understands that limits within the spot-month may be effective to prevent 'corners and squeezes' at settlement, the case for placing position limits in non-spot-months is less convincing and has not been made by the Commission. We note that the Dodd-Frank Act at section 737 states that the Commission shall set position limits "as appropriate" and "in its discretion" to diminish, eliminate, or prevent excessive speculation; deter and prevent market manipulation, squeezes, and corners; ensure sufficient market liquidity for bona fide hedgers; and ensure that the price discovery function of the underlying market is not disrupted. This mandate from Congress provides the opportunity for the Commission to consider whether the position limits are appropriate in the non-spot-months and we would encourage the Commission to conduct an evidence-based assessment of the likely impact of these limits before introducing them.

If the Commission proceeds with these limits as proposed, AIMA supports the Commission in choosing to delay the introduction of non-spot-month positions limits until sufficient data has been collected to be able to properly assess the open interest. To do otherwise would risk setting inappropriate limits that could reduce liquidity in the market and possibly create the volatility and high prices that the limits are designed to prevent. As stated above in relation to spot-month limits, it may be appropriate to set limits higher than they may initially be expected to be set at. Although we have no particular issues with the 10% limit for the first 25,000 contracts, it may be more appropriate to start with a 5% limit for contracts over 25,000 until a real assessment on the impact of the new limits can be conducted. If this is found to be too high on an objective assessment, the Commission may later consider a reduction of the 5% element of the limit. The Commission questions whether the swap class should be further divided into cleared and uncleared swaps. Factoring in clearing to the limits would unnecessarily complicate the proposal. AIMA fully supports the Commission in its efforts to encourage clearing of swaps, but using categories of cleared and uncleared swaps to subdivide a swaps class is not appropriate when setting position limits as it does not relate to the method of trading or form of the contract, which may be relevant to the price. Additionally, swaps which are eligible for clearing may change from time to time as a CCP offers to clear certain swaps or the Commission approves certain swaps for mandatory clearing – this makes setting position limits based on whether a swap is cleared or not difficult and burdensome from a compliance perspective.

The non-spot-month position limits, as proposed, split out into 6 different limits combining the two classes of contract (futures and options contracts, and swaps contracts), aggregate of the two classes and limits for each month as well as an all-month limit. The reasons for each of the limits are explained in the Commission's proposed rules, however as proposed this would seem to be an unnecessary level of complexity given the intended goals. It may be necessary to have both single-month and all-month limits, but a simplification can be achieved by either removing the aggregate limits or just having aggregate limits (as is done with spot-month limits). The aggregate limits have been proposed as there is concern about parties holding offsetting positions across the classes that make the party neutral but appearing to hold excessive positions in the market. Offsetting positions are also possible within the swap class as well as across the classes, and large offsetting positions are unlikely to be taken except in relation to bona fide hedging (which is exempt). Either an aggregated limit or a limit for each of the class should be used. Removal of unnecessary limits helps cut down on the already high compliance burden for non-exempt firms, and complications for the Commission in enforcing these limits.

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For legacy positions limits, these have developed over time and have succeeded in their goals of ensuring sufficient market liquidity and prevent parties taking positions which distort price discovery. We agree that it makes sense to increase the single-month limit in line with the existing all-months-combined limit to conform the legacy limits to the proposed Federal position limits. The all-month-combined limit levels however should be retained but, as with the other limits, be kept under review to ensure that the limits meet a correct balance that ensures proper price discovery and market liquidity. Where parties have established positions in good faith prior to the introduction of the proposed rules these should be permitted after the new limits' introduction, including where parties "roll over" contracts before they reach the spot-month in order to maintain position allocations.

Exemptions for referenced contracts

The exemption from positions limits for *bona fide* hedging transactions or positions is an important element of the position limits regimes and allows necessary positions to be taken by certain market participants to reduce their overall risk exposure. For this reason, we support the Commission's proposal to fully implement the Dodd-Frank Act's *bona fide* hedge exemption, obtainable through the use of futures contracts, options <u>and</u> swaps. As market participants currently utilise the *bona fide* hedging exemption, the exemption in relation to the new proposed Federal position limits should as closely as possible align with the existing and understood definition. This should include in certain circumstances financial hedging, as is currently permitted under the CEA exemption (e.g., non-speculative positions taken to hedge other financial activities), and we do not believe anything in the Dodd-Frank Act prevents this interpretation.

Position Visibility

AIMA believes the Commission should be able to have proper oversight of the market and therefore it is important that the Commission is able to know, where necessary, the positions of the largest traders in given markets. We are aware that the European Commission, for example, has recently consulted on a 'position management' regime in its review of the Markets in Financial Instruments Directive (MiFID) that would operate on similar lines to the position visibility regime proposed. This is likely to be the most effective way to control large positions in the market, as it will give the Commission opportunity to engage with parties building positions in certain commodities and allow them to explain their strategies and motivations. The Commission also recognises a position accountability regime for certain excluded commodities traded on designated contract market (DCM) (see below).

Our main concern is to ensure that information on positions is, where not otherwise reported publicly, kept confidential by the Commission. Any publication is likely to damage the commercial interests of those parties taking the position, but may also cause other parties to follow the strategy of others and lead to multiple parties taking large positions in a market, collectively affecting the market price, where this would not otherwise happen.

The setting of position visibility limits to capture the top set of traders in a market is one possible approach to setting the limits. A further sensible approach could be to set the visibility limits as a percentage of the position limits, which will vary as the limits continue to be assessed. Although we are less concerned with the visibility limits for positions, as these will not affect market liquidity and price discovery, we question why it is necessary at the outset to keep under closer scrutiny oil and gas contracts compared with other markets. It is likely that different commodity contracts will vary in importance over time and the Commission should set and adjust limits so that they may properly review positions being built at any one time in any contract of concern. It seems unnecessary to exclude, as a rule, referenced agricultural contracts, and the Commission should consider including these at a sufficiently high level for later adjustment where necessary.

Aggregation of Accounts

Whilst it is necessary to aggregate some positions managed by a single trader to prevent circumvention of the position limits, we are particularly concerned about the possible effects of having to aggregate positions held

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across separately managed commodity pools.

The assets and funds of a commodity pool or managed account are directly owned by the investors in the pool or investor in the managed account and thus it is they who hold the positions for the purposes of the proposed position limits. They however do not control trading which is done at various levels by the CPO who operates the commodity pool and controls the pool vehicle and the CTA which has trading teams making the day-to-day decisions on the investments of the pool or managed account.

We are concerned by the proposed requirement for investors with a significant equity interest in a commodity pool to aggregate all positions of the commodity pool with the positions they have in other commodity pools or via direct trading. This causes the concern that as the investor will not control the trading of the pool, they will not be able to ensure that their position held as part of the pool, added to their positions held outside of the pool, will remain under the federal position limits. The positions of the pool will have to be under the federal position limits as they are controlled by the CPO and CTA, as will the investor's (as trader) position outside of the pool, however it may be easy to very quickly breach the position limits in aggregate for large investors with multiple methods of investing (e.g. large institutional investors including pension funds who make multiple investments to seek diversification of their portfolio of investments). Investors themselves will not likely know the day-to-day positions taken by the controllers of the commodity pool on their behalf and therefore it will be burdensome to adjust their other positions to stay under the proposed federal limit. To require the CPO/CTA to report the daily positions to the investors will be equally burdensome and may also be too late at any one time to prevent a breach of the limits if a report is made only after a trade is executed. The result is such that many investors will be unwilling to take a large equity interest in commodity pools in order to avoid the risk of breaching the proposed position limits. This can cause the number of independent traders to be reduced, with resulting effects for market liquidity and investor choice.

The exception to the aggregation rule in section 151.7(c) provides a limited exemption for a commodity pool participant where they have an ownership or equity interest greater than 10% of the pooled accounts or positions, where the pool operator has procedures that would prevent the investor having knowledge about the trading positions of the pool, where the investor has no control over the trading decisions of the pool and where the pool operator has received an exemption from aggregation on behalf of the investor (or investors within a class to which they belong). However, if that investor has an interest of greater than 25% of the equity or ownership of the pool, they must aggregate the entire position of the pool with all other positions (either gained in further pools or on its own account). A change has been made to the similar exemption in Part 150 of the CFTC Regulations in that the 25% aggregation rule now applies to any commodity pool, not just those who's operators are exempt from registration as a CPO with the Commission under § 4.13 (i.e. private pools). For those investors with greater than 25% interest in a commodity pool, they are now therefore effectively prohibited from having an interest of greater than 25% in any other pools. The existing rules under Part 150 are more effective in that, whilst having the same safeguards for exempt pools (including that the investor will not know the positions of the pool or control trading), the Commission could regulate non-exempt pools via the CPO and oversee positions that may be being built and engage with the CPO as to the reasons for establishing the position. This proposed change is heavy handed and unnecessary to achieve the purpose of overseeing and limiting parties in their ability to get round the proposed position limits.

For traders trading their own assets, many institutions (including CTAs and CPOs) have in the past sought to reply on the 'independent account controller exemption' present in Part 150 that allows them to allocate control over those assets to independent trading teams who are operationally independent of each other and have no knowledge of the teams' trades and positions, and thus collectively hold positions above the federal position limits. This exemption has worked without issues for many years and has reflected both the way in which financial entities are structured and controlled, and a common sense approach to position limits whereby (a) accounts are separately controlled and (b) independent account controllers have no knowledge of the trading decisions of other independent account controllers, which means that there is no opportunity to intentionally and purposefully build positions which circumvent the federal position limits. This exemption has also been used in relation to large multinational organisations, which have independent business units (or different legal entities) each active in futures trading for differing reasons. These entities are operationally independent from

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one another and trade for fundamentally different reasons. Some of AIMA's members are part of large financial groups that include not only asset management subsidiaries and CTAs, but also Futures Commission Merchant subsidiaries, and investment banking subsidiaries who trade for commodities corporate hedging or market-making. Trading decisions taken by each such subsidiary are totally independent from the other subsidiaries within the group, are driven by unrelated processes, and are not shared across the Group of subsidiaries / entities. They have therefore been able to establish appropriate policies and processes to keep those trading strategies separate and have relied upon the independent account controller exemption.

Instead of reintroducing the independent account controller exemption (which the Commission has intentionally excluded), we would urge the Commission to instead consider changing the proposed 'owned non-financial entity exemption' at section 151.7(f) into an 'owned entity exemption' and thereby allow entities and large investors in commodity pools that are clearly independent – having no knowledge of trading decisions, no shared control over trading and written policies and procedures to facilitate this – to qualify for an exemption from aggregation in the same way proposed for non-financial entities. The equal treatment for financial and non-financial entities would reflect a fair and common sense approach that takes account of the need to prevent wilful avoidance of the proposed position limits and the benefits to the market of trading from both financial and non-financial entities.

Without such exemptions the aggregation of position limits for CTAs, CPOs and other financial institutions will be burdensome and difficult to comply with, and may have effects including a reduction in legitimate trading activity and an overall reduction in market liquidity, resulting in poorer price discovery and greater price volatility.

Procedure for applying for exemptions from the position limits and exemptions from aggregation of position limits

The Commission proposes that where a trader wishes to utilise one of the available exemptions it must first apply to the Commission for permission to use the exemption. We appreciate that the self-executing nature of existing position limit exemptions does not allow the Commission to review the use of every exemption, however the requirement to apply for an exemption in all cases is likely to be unworkable. The proposed rules are unclear about when the application for exemption must be made, and the changing nature of business structures and the parties with whom traders interact may require regular filings (e.g. as an investor, is an exemption necessary for each investment it makes?). The Commission is likely to be overwhelmed with details and parties applying for exemptions from rules, and this is both administratively burdensome for the Commission and is likely to be unmanageable for smaller traders and investors who are not ever likely to breach the limits in any case but must file an application to ensure its compliance with the rules. In particular, we feel that the requirement to apply for an exemption from aggregation (with the accompanying annual reapplication requirement) in the case of investors holding a large equity interest in a commodity pool is not desirable.

Registered entity position limits

Registered entities, including DCM and swap execution facilities (SEFs), may wish to impose their own position limits to control prices and volatility on their markets, and we agree that these should not be such as to affect the limits imposed by the proposed rules. As stated above, we believe a preferable option for many markets is likely to be a position accountability regime, as the Commission proposes for excluded commodities trading on a DCM subject to certain conditions. We therefore support that the Commission recognises that position accountability may be more appropriate for certain contracts with lower levels of open interest.

Conclusion

Overall, we believe the Commission has proposed sensible rules for implementation of Federal position limits as required by the Dodd-Frank Act, and we support the phased implementation of the specific limits which will take account and only take effect upon the provision of accurate market data. However, as stated we are concerned about the aggregation of limits for certain traders and believe these rules must be rethought. To achieve the

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goals of section 737 of the Dodd-Frank Act we would also encourage substantial international cooperation and coordination to avoid commodity market trading activity moving from US markets to foreign boards of trade.

We thank you for this opportunity to comment on the Commission's proposed rules and are, of course, very happy to discuss with you in greater detail any of our comments.

Yours sincerely,

Jiří Król
Director of Policy & Government Affairs

June 20, 2011
Mr. David A. Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington DC 20581

Re: Notice of Proposed Rulemaking — Position Limits for Derivatives

Dear Mr. Stawick:

The Asset Management Group (the "**AMG**") of the Securities Industry and Financial Markets Association ("**SIFMA**") appreciates the opportunity to provide the Commodity Futures Trading Commission (the "**Commission**") with certain additional comments and recommendations set forth below regarding the proposed rules (the "**Proposed Rules**") published in the Commission's Notice of Proposed Rulemaking (the **"NPR"**)[1] relating to position limits under Section 737 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Dodd-Frank Act**"). These comments and recommendations are principally directed at the Commission's proposed new account aggregation standards and supplement the AMG's comment letter dated March 28, 2011 (the "**AMG Prior Letter**").[2]

The AMG's members represent U.S. asset management firms whose combined assets under management exceed $20 trillion. The clients of AMG member firms include, among others, registered investment companies, ERISA plans and state and local government pension funds, many of whom invest in commodity futures, options and swaps as part of their respective investment strategies.

As noted in the AMG Prior Letter, the AMG supports the goals set forth in the Dodd-Frank Act for setting appropriate position limits, namely to prevent market manipulation, ensure sufficient market liquidity for bona fide hedgers, and deter disruption to price discovery, including preventing price discovery from moving to foreign boards of trade ("**FBOTs**"). However, as we also noted, position limits present the danger of undermining the stated purposes, particularly if set prematurely or at too restrictive levels and without proper exclusions. Indeed, Congress recognized that position limits, if set

1 Position Limits for Derivatives, 76 Fed. Reg. 4752 (Jan. 26, 2011) ("**NPR**"), available at http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-1154a.pdf.

2 *See* AMG Prior Letter (filed Mar. 28, 2011), available at http://www.sifma.org/Issues/item.aspx?id=24149.

inappropriately, may adversely impact market liquidity, disrupt the price discovery function of the U.S. commodity markets and cause migration of trading activity to FBOTs. Because the Commission's aggregation policy determines whether a market participant must treat positions in different accounts as its own for purposes of complying with position limits, the AMG believes that these issues are closely intertwined and that the combined effect of the Commission's proposed position limits, the proposed limited application of the bona fide hedging exemption, and the novel and burdensome proposed new account aggregation standards would have a serious adverse effect on market liquidity.

We renew all of the comments raised in the AMG Prior Letter, but in view of the Futures Industry Association's ("**FIA**") supplemental comment letter dated May 25, 2011 (the "**FIA Comment Letter**"), in which the AMG concurs, we are reiterating and expanding upon our comment raised in the AMG Prior Letter that the Commission should not require the aggregation of positions among managed funds and accounts where such funds and accounts are separately owned and controlled.[3]

The FIA Comment Letter sets forth the serious concerns presented by the Commission's apparent intention to require the common parent of an integrated group of financial service companies to aggregate all positions traded by its futures commission merchant ("**FCM**") and dealer subsidiaries on its behalf with positions traded independently by its walled-off asset management subsidiaries on behalf of their third party clients due to the ultimate common ownership of the companies. The AMG fully shares these concerns, including the lack of appropriate notice regarding the intended application of the FCM exemption, the novel and unprecedented mixing of the ownership and control criteria, and the apparent reinterpretation of the control criterion. As set forth in the FIA Comment Letter, the AMG emphatically agrees that, if adopted, such an aggregation standard would have a highly detrimental impact on the markets and market participants, with severe consequences for asset management firms and their clients.

Upon review of the FIA Comment Letter and our further analysis of the Proposed Rules, the AMG again strongly urges the Commission to revisit the approach apparently intended with respect to its aggregation policy. In this regard, the AMG requests that the Commission expand the owned non-financial entity exemption to financial entities that meet the same criteria and retain the independent account controller exemption, as requested in the AMG Prior Letter. See Part I of this letter. In addition, the AMG separately requests that the Commission continue to permit disaggregation of positions in separately owned funds and accounts, particularly where common ownership of the positions as well as common control of the trading decisions do not exist. See Part II of this letter.

[3] We also renew the comments raised in the AMG Prior Letter, including (i) that it is premature to adopt any limits without adequate data on open interest in the commodity swaps market and sufficient studies of the impact of speculative limits on price, volatility and liquidity; (ii) limits, when established, should not be overly restrictive; (iii) safe harbors should be considered for registered investment companies, ERISA and similar accounts, and funds and accounts that are diversified and unleveraged and take passive, long-only positions; (iv) expansion of the bona fide hedging exemption; and (v) that the Commission should not require the aggregation of positions among separate managed funds and accounts.

I. The Commission's proposal to require aggregation of the positions of all entities that share a 10% or greater ownership interest (regardless of control) is unduly rigid and disregards independent management that frequently exists between and among entities that may have common ownership.

The AMG strongly believes that entities that operate separately and independently from one another should not have to combine their trading positions pursuant to a rigid and inflexible aggregation requirement, which would in any event do nothing to address the Commission's concern about preventing excessive speculation and manipulation. In such cases the Commission staff has historically confirmed that a passive investment in another entity does not require the acquiring entity to aggregate the futures positions that may be held by the other entity, absent any indicia of control over the other entity's trading activities. Like the Commission, other federal regulators have generally provided for disaggregation of holdings of financial companies where positions are independently controlled or where appropriate information barriers are in place.[4]

Indeed in the NPR, the Commission has proposed an exemption in the Proposed Rules referred to as the "owned non-financial entity exemption", which would permit an entity to disaggregate its own positions from those of an entity in which it owns a 10% or greater ownership or equity interest if such entity is independently controlled and managed.[5] The Commission states that this exemption is intended to allow disaggregation of a holding company that has a passive ownership interest in one or more operating companies. The Commission states further that it would be inappropriate to aggregate positions where an operating company has complete trading and management independence from the holding company. The AMG agrees with the Commission. However, nowhere in the NPR does the Commission explain why financial entities for which the operating companies may have complete trading and management independence from the holding company, including asset management subsidiaries or the operating companies that they make investments in, should not equally be eligible for a similar exemption. If traders are truly independent, whether they are financial or non-financial entities, the Commission should treat them as such and each such entity should be eligible for its own separate limit. The AMG believes that this principle should apply, whether an entity is trading for itself or for third party clients, where of course common ownership of the positions does not exist.

Moreover, in contrast to non-financial companies, financial entities are generally heavily regulated and as noted in the AMG Prior Letter, are already frequently subject to information barriers to address regulatory, contractual or fiduciary concerns. The Commission clearly has endorsed the use of information barriers as an effective safeguard in preventing the unlawful sharing of information or preventing affiliated entities from acting in concert. In this regard, the Commission recently proposed establishing information barriers to ensure that swap dealers', major swap participants' and FCMs' risk-taking units do not interfere with decisions made by an affiliated clearing firm regarding whether to accept a trade for clearing.[6] Since the Commission is taking the view that information

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[4] *See* Amendments to Beneficial Reporting Requirements, Exchange Act Release No. 34-39538, 63 Fed. Reg. 2854, 2857-58 (January 12, 1998) (noting that "procedures reasonably designed to prevent the flow of information to and from other business units" may be relied upon "to avoid attributing beneficial ownership to the parent entities.").

[5] *See* NPR, *supra note* 1, 76 Fed. Reg. at 4762-4763.

[6] *See* 75 Fed. Reg. at 71391, 71393 (November 11, 2010) and 75 Fed. Reg. at 70152, 70154 (November 17,

barriers are sufficient to protect access to central clearing, the same rationale should permit a financial entity and its affiliated entities that have similar information barriers in place, reflecting separate and independent trading activities and management independence, to disaggregate their positions. Conversely, requiring aggregation could have the counterproductive effect of exacerbating the very concerns regarding concerted action (whether deliberate or inadvertent) that apparently form the basis of the Commission's proposal to eliminate the independent account controller exemption for financial entities under the Proposed Rules.

If the Commission is concerned that information barriers that have been established between commonly owned financial entities may be insufficient for ensuring truly independent trading among affiliated entities, the Commission has other means at its disposal to address this concern more reasonably and appropriately.[7] Moreover, to address any residual concerns regarding the potential evasion of speculative position limits, the Commission may exercise its existing authority to obtain any pertinent information concerning positions and transactions relating to any commodity in which a trader owns or controls a reportable position and also issue a "special call" to obtain any additional information, if necessary or appropriate.[8] Ironically, requiring financial entities to monitor positions across affiliates where information barriers exist may cause them to breach these barriers which have been put in place for regulatory and other valid business purposes, as well as their fiduciary or contractual duties to their clients. Thus, the AMG strongly believes that an exemption applicable only to owned non-financial entities is insufficient, is unsupported by any valid rationale or regulatory concern, and requests that the Commission reconsider this aspect of its proposal.[9]

Consistent with the foregoing, the Commission should continue to permit the existing safe harbor under Rule 150.3(a)(4)(i), often referred to as the "independent account controller exemption", where common ownership of the positions does exist. This exemption has existed in different forms since 1988 and has worked well, without any reported instances of non-compliance with its provisions. The Commission does not explain in the NPR how independently controlled accounts pose a risk of coordinated excessive speculation or manipulation, or how retaining this longstanding exemption would be inconsistent with the Commission's proposed position limits. In view of the lack of adequate rationale in the NPR, the Commission should establish further evidence to justify its concerns before proceeding to curtail the availability of this exemption in such a drastic fashion.

II. The Commission should continue to permit disaggregation where common ownership of positions and control of trading decisions do not exist.

Irrespective of whether the Commission expands the owned non-financial entity exemption to financial entities that meet the same criteria or retains the independent account controller exemption, it is now our impression that the Commission intends to require the aggregation of positions even where common ownership of the positions and common control of the trading decisions do not exist, including

2010).

7 As set forth in the AMG Prior Letter, a more effective means of deterring fraudulent activity would be to enhance detection and enforcement remedies.

8 *See* Commission Rule 18.05 and Commodity Exchange Act § 4(i).

9 In addition, in order for such an exemption to be workable for applicants and the Commission and its staff, the AMG strongly believes that an exemption should be effective upon filing of an application in good faith.

in the circumstances described in the FIA Comment Letter with respect to the FCM exemption and referenced earlier, but also in other contexts as well. The AMG agrees with FIA that such an aggregation standard is not supported by any fair reading of the Dodd-Frank Act, the Proposed Rules, the Commodity Exchange Act, or the NPR. In the context of asset management firms which utilize sub-advisers to manage client portfolios, or that sub-advise portfolios, whether or not the entities are affiliates, the asset management firms do not exercise day-to-day control of the trading decisions of these sub-advisers and only maintain such minimum amount of control as is consistent with their fiduciary responsibilities to fulfill their duty to supervise the trading done for client portfolios.[10] This also holds true with respect to fund-of-funds structures where the fund-of-funds and the fund-of-funds managers do not control the trading decisions of the external funds in which they invest for client portfolios. This model is widespread in the asset management industry and has been used for decades without any reported instances of intent to evade position limits. Indeed, the Commission has always recognized that an adviser which does not exercise day-to-day control of trading for a client account should not be required to aggregate the positions for purposes of position limits or its large trader reporting requirements.[11] This is because in such circumstances the asset management firms do not control the trading decisions made by the sub-advisers and the sub-advisers are trading separately and independently. Thus, imposing such an aggregation requirement would be a radical change in the Commission's historic policy without any substantive reason and would not advance any regulatory policy or purpose.

The consequences of implementing such an aggregation requirement for asset management firms and their clients would be extremely serious, particularly if limits are set too low. Among other things, all market participants would suffer from a significant reduction in market liquidity, the consequential increase in costs to market participants, and also the negative impact on investment returns and their ability to accomplish legitimate investment and risk management strategies. It should also be emphasized that other federal regulators have followed the same approach as the Commission's longstanding policy and continue to do so, including the Securities and Exchange Commission with respect to securities ownership under Sections 13 and 16 of the Securities Exchange Act of 1934, as amended (the "**Exchange Act**").[12] Such a massive departure from longstanding policy without an adequate rationale and without appropriate notice inevitably will have unforeseen adverse consequences.

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[10] Of course, if an asset management firm retains day-to-day control over the trading of sub-advised accounts, aggregation of those accounts would be required under current law.

[11] *See* Part 150 of the Commission's Rules, (17 C.F.R. Part 150 (2010)) and Part 17 and 18 of the Commission's Rules (17 C.F.R. Part 17, 18 (2010)), respectively.

[12] *See* Exchange Act Rule 13d-3(d)(1).

The AMG thanks the Commission for the opportunity to submit these additional comments and recommendations on the Proposed Rules. Consistent with the FIA Comment Letter, the AMG respectfully requests that the Commission clarify its intention by republishing the Proposed Rules for public comment with an adequate explanation. The AMG would welcome the opportunity to further discuss our comments with you. Should you have any questions, please do not hesitate to call the undersigned at 212-313-1389.

Sincerely,

Timothy W. Cameron, Esq.
Managing Director, Asset Management Group
Securities Industry and Financial Markets Association

Alternative Investment Management Association

David A. Stawick,
Secretary of the Commission,
Commodity Futures Trading Commission,
Three Lafayette Centre,
1155 21st Street, NW.,
Washington, DC 20581

17 January 2012

Dear Sirs,

Position Limits for Futures and Swaps – interim final rule

The Alternative Investment Management Association (AIMA)[1] welcomes the opportunity to provide comments on the Commodity Futures Trading Commission's (the Commission) interim final rule on position limits for futures and swaps, which establishes spot-month limits for 28 physical commodity futures and options contracts and their economically equivalent swaps. We also wish to highlight our concerns regarding the deliverable supply estimates that the Commission will use to calculate all spot-month position limits.

AIMA's comments

Interim Final Rule

The goal of the position limits rule, set out at section 6A(a) of the Commodity Exchange Act of 1936 (as amended) (the Act), is to ensure that, with respect to holding positions in commodity futures or economically equivalent swaps contracts that perform or affect a significant price discovery function, traders in those contracts do not cause "sudden or unreasonable fluctuations or unwarranted changes in the price of such commodity". In essence, section 6A(a) and the Commission's Final Rule, published in the Federal Register on 18 November 2011, seek in particular to avoid unnecessary 'congestion' of interest around settlement of a contract in the delivery month (the Spot-Month), which causes its price to increase significantly before settlement.

Respondents to the notice of proposed rulemaking (NPR), published on 26 January 2011, commented that the Commission may wish to adopt Spot-Month position limits that have either:

- a larger ratio for cash-settled contracts cf physically-settled contracts; or

- no limit on cash-settled contracts at all.

AIMA commented in response to the NPR that positions taken in physically-settled contracts are likely to have some form of direct impact on the market price of the underlying commodity in the Spot-Month. However, cash-settled derivatives contracts may have a less direct effect and, thus, we felt that it may be beneficial either to have a limit multiple times that for the physically-settled contract or for the Commission to consider whether the limits for cash-settled contracts were appropriate at all.

As AIMA and other industry participants have stated, the relationship between the cash-settled commodity derivatives market and the underlying cash commodity market (the Cash-Market) is not fully understood. Contracts under which market participants are never required to take physical delivery of an underlying commodity cannot correspondingly reduce the amount of supply of the physical commodity available in the Cash-Market. The lack of impact on the physical supply may mean that a position taken in a cash-settled contract

1 AIMA is the trade body for the hedge fund industry globally; our membership represents all constituencies within the sector – including hedge fund managers, fund of hedge funds managers, prime brokers, fund administrators, accountants and lawyers. Our membership comprises over 1,300 corporate bodies in 45 countries.

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would not be expected, in any meaningful or significant way, to increase or decrease the Cash-Market price of the underlying commodity (i.e., the position is unlikely to have a 'significant price discovery function'). However, cash-settled contracts provide a way for parties who are exposed to the Cash-Market (e.g., manufacturers) to hedge their exposures against adverse price movements. Professional investors also use investments in cash-settled commodity derivative contracts as an uncorrelated investment to maintain a diversified portfolio, ultimately helping to reduce the risks to investors' capital.

Given the benefits of being able to invest freely in cash-settled contracts, we believe that the Commission should give serious consideration as to whether there are reasons for having limits for Spot-Month cash-settled commodity derivative contracts and, if so, what those limits should be. Section 6A(a)(4) of the Act lists considerations to be taken into account when determining whether a swap contract performs a 'significant price discovery function'. These include: (i) the price linkage between the swap and Cash-Markets; (ii) the ability to arbitrage between the two markets; (iii) the extent to which the Cash-Market prices are based on the swap-market prices; (iv) the impact of liquidity in the Cash-Market as a result of trading in the swap-market; and (v) other material factors. We believe that it is possible that physical-delivery contracts have a different relationship to the price discovery function in relation to Cash-Markets from that of cash-settled contracts.

We would, therefore, support the Commission conducting an independent study and cost-benefit analysis in this regard, as we do not believe the evidence on which this rule is based is sufficient. If the outcome of this is to demonstrate a clear causal link between cash-settled contract positions and underlying Cash-Market prices, then we would urge consideration of what limits may be appropriate.

If the Commission concludes that limits for cash-settled contracts are appropriate, then we believe that the limits should be set as a multiple of the physically settled limits, according to clear evidence that suggest the correct multiplier. We believe that there is no specific evidence to suggest that a multiple of five times the physical-settled contract position limit is the appropriate ratio and we believe that a final ratio cannot be agreed until a study on the actual impact on Cash-Markets has been conducted. Given the goals set out in section 737 of the Dodd-Frank Act, the agreed ratio should be appropriate to:

- diminish, eliminate, or prevent excessive speculation;
- deter and prevent market manipulation, squeezes, and corners;
- ensure sufficient market liquidity for bona fide hedgers; and
- ensure that the price discovery function of the underlying market is not disrupted.

Following the conclusion of the study discussed above, we believe that each specific type of commodity merits a different sized position limit based on the evidence, rather than applying a one-size-fits-all approach (e.g., just having a five times multiplier). The Commission should also monitor over time these ratios to ensure that the multiplier used remains appropriate.

We believe that the proposed rules around holding both cash- and physically-settled contracts for the Henry Hub Natural Gas contract, which have different limits based on a five times ratio, are appropriate and should be applied for all 28 core referenced futures contracts.

Estimated deliverable supply

In the Commission's final rule on position limits for futures and swaps, the spot-month position limits will be those set out at Annex A of the rule, being applicable from the date that the limits comes into force up to the date at which they are revised[2]. At the date the limits are revised, the position limits will be based on the estimates of deliverable supply agreed between the Commission and the relevant designated contract markets (DCMs). The spot-month limit will be 25% of the estimated deliverable supply, which will be reconsidered annually or biennially (depending on the type of contract) thereafter based on the latest estimated deliverable supply figures.

[2] i.e., 1 January in the second calendar year following the date at which the rule defining the definition of "swap" is published

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The limits in Appendix A are based on the limits previously used by the DCMs, which themselves are based on estimates of deliverable supply. However, we are aware that some of the estimated delivery supply numbers on which the position limits in Appendix A are based are out of date and do not reflect current market supply of the commodities. For example, the supply figure on which the natural gas contract position limits would be based has not been updated for around 12 years. We understand that it is likely that the deliverable supply estimates for many of the contracts will have increased meaningfully since they were last calculated.

We believe that the Commission should seek new estimated deliverable supply numbers from the DCMs today and ensure that, when the regime is introduced, from the start limits are based on up-to-date evidence based numbers. It should not wait two years to obtain these and should further consider whether annual and biennial updates are appropriate or whether updates to the estimates should be considered more frequently. Without using accurate and appropriate supply numbers, the Commission cannot hope to introduce an appropriate position limits regime that achieves its goals of protecting against excessive speculation and manipulation while ensuring that the markets retain sufficient liquidity for bona fide hedgers and that their price discovery functions are not disrupted.

As a prerequisite to any study or adjustment of the position limit ratios between physically-settled and cash-settled contracts, the Commission must ensure that the estimated deliverable supply numbers the limits are based on are appropriate.

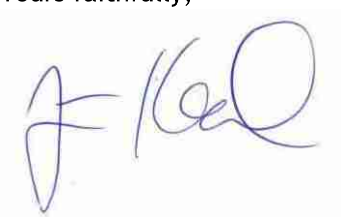
Conclusion

We believe that the Commission has not thus far provided sufficient evidence and cost-benefit analysis to show that cash-settled contracts have a significant impact on underlying Cash-Market commodity prices. Therefore, we encourage the Commission to study the relationship between the Cash-Markets and the cash- and physically-settled futures and swaps markets, looking at both the costs and the benefits of this rule and only then introduce rules for cash-settled Spot-Month commodity derivatives if they are appropriate and at the correct ratio above that for physically-settled contracts.

The Commission must also ensure that position limits are based on suitable estimated deliverable supply numbers. This can only be done if the Commission begins the regime with the correct numbers and updates the estimates as frequently as is necessary to ensure the limits are appropriate to achieving the goals of the final rule.

We thank you for this opportunity to comment on the Commission's interim final rule and are, of course, very happy to discuss with you in greater detail any of our comments.

Yours faithfully,



Jiří Król
Director of Government and Regulatory Affairs

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, et al. Plaintiffs, v. **UNITED STATES COMMODITY FUTURES TRADING COMMISSION** Defendant.	Civil Action No. 11-cv-2146 (RLW)

MEMORANDUM OPINION

Plaintiffs International Swaps and Derivatives Association ("ISDA") and Securities Industry and Financial Markets Association ("SIFMA") (collectively "Plaintiffs") challenge a recent rulemaking by Defendant United States Commodity Futures Trading Commission ("CFTC" or "Commission") setting position limits on derivatives tied to 28 physical commodities. See Position Limits for Futures and Swaps, 76 Fed. Reg. 71,626 (Nov. 18, 2011) ("Position Limits Rule"). The CFTC promulgated the Position Limits Rule pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) ("Dodd-Frank").

The heart of Plaintiffs' challenge is that the CFTC misinterpreted its statutory authority under the Commodity Exchange Act of 1936 ("CEA"), as amended by Dodd-Frank. The central question for the Court, then, is whether the CFTC promulgated the Position Limits Rule based on a correct and permissible interpretation of the statute at issue. Before the Court are the following motions: 1) Plaintiffs' Motion for Preliminary Injunction (Dkt. No. 14), Plaintiffs' Motion for Summary Judgment (Dkt. No. 31) and Defendant's Cross Motion for Summary Judgment (Dkt. No. 38). For the reasons set forth below, Plaintiffs' Motion for Summary Judgment is

GRANTED, the CFTC's Cross-Motion for Summary Judgment is **DENIED**, and Plaintiffs' Motion for Preliminary Injunction is **DENIED AS MOOT**.[1]

FACTUAL BACKGROUND

ISDA is a trade association with more than 825 members that "represents participants in the privately negotiated derivatives industry." (Compl. ¶ 9). SIFMA is an "association of hundreds of securities firms, banks, and asset managers" whose claimed mission is to "support a strong financial industry, investor opportunity, capital formation, job creation, and economic growth, while building trust and confidence in the financial markets." (Id. ¶ 10). According to Plaintiffs, the commodity derivatives markets are "crucial for helping producers and purchasers of commodities manage risk, ensuring sufficient market liquidity for bona fide hedgers, and promoting price discovery of the underlying market." (Id. ¶ 15). The CFTC, of course, is an agency of the U.S. government with regulatory authority over the commodity derivatives market.

Relevant Derivatives Contracts

Three types of commodity derivatives are implicated in this case: futures contracts, options contracts and swaps. (Dkt. No. 31 at 5). A futures contract is a contract between parties to buy or sell a specific quantity of a commodity at a particular date and location in the future. (Id. at 3). An options contract is a contract between parties where the buyer has the right, but not the obligation, to buy or sell a specific quantity of a commodity at a point in the future. (Id.).

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[1] The Court finds it appropriate to consolidate consideration of the cross motions for summary judgment with Plaintiffs' Motion for Preliminary Injunction given that: the Position Limits Rule has not yet gone into effect; briefing on summary judgment is ripe; the parties have had a full and fair opportunity to present their entire cases on the merits and, thus, there is no prejudice from consolidation; and the parties have concurred that this case is properly disposed of on summary judgment. See Fed. Civ. P. Rule 65(a)(2); see also 11A Charles Alan Wright, Arthur R. Miller & Mary Kay Kane, Federal Practice and Procedure § 2950, 239 (2d ed. 1995) (stating that consolidation will be considered proper "if it is clear that consolidation did not detrimentally affect the litigants as, for example, when the parties in fact presented their entire cases . . . .").

Futures contracts and options contracts result in either physical delivery or a cash settlement between parties. (Id.). In a physical delivery contract, the buyer takes physical delivery of the commodity when the contract expires. (Id.). At the conclusion of a cash-settled contract, a cash transfer occurs that is equivalent to the difference between the price set forth in the contract and the market price at the time the contract expires. (Id.). Swaps involve one or more exchanges of payments based on changes in the prices of specified underlying commodities without transferring ownership of the underlying commodity. (Id. at 5).

A position limit "caps the maximum number of derivatives contracts to purchase (long) or sell (short) a commodity that an individual trader or group of traders may own during a given period." (Compl. ¶ 21). A position limit may impose a ceiling on either a "spot-month" position or a "non-spot-month" position. (Id. at ¶ 22). A "spot month" is a specific period of time (which varies by commodity under the rules) that immediately precedes the date of delivery of the commodity under the derivatives contract. (Id.). As Plaintiffs explain, "[a] spot-month position limit, therefore, caps the position that a trader may hold or control in contracts approaching their expiration. A non-spot-month position limit caps the position that may be held or controlled in contracts that expire in periods further in the future or in all months combined." (Id.).

Commodity Exchange Act of 1936 and the 2010 Dodd-Frank Amendments

The main issue in this case is whether the Dodd-Frank amendments to Section 4a of the CEA (codified at 7 U.S.C. § 6a)[2] mandated that the CFTC impose a new position limits regime in the commodity derivatives market. It is undisputed that, prior to Dodd-Frank, the CEA vested the Commission with discretion to set position limits on futures and options contracts in commodity derivatives markets. See 7 U.S.C. § 6a (stating that CFTC has authority to proclaim and fix position limits "from time to time" "as the Commission finds are necessary to diminish,

[2] This Court will refer to the statute by its United States Code number.

eliminate, or prevent [excessive speculation]."). Title VII of the Dodd-Frank Act amended Section 6a in several respects. The full text of Section 6a, with the Dodd-Frank amendments reflected in red-lined format, is attached to this Opinion as Appendix A.

The Position Limits Rule

Notice of Proposed Rulemaking

Dodd-Frank went into effect on July 21, 2010. On January 26, 2011, the CFTC issued a Notice of Proposed Rulemaking ("NPRM"), stating that Title VII of Dodd-Frank "requires" the Commission "to establish position limits for certain physical commodity derivatives." Position Limits for Derivatives, 76 Fed. Reg. 4,752 (Jan. 26, 2011). At an open meeting on January 13, 2011 prior to the issuance of the NPRM, Commissioner Michael V. Dunn stated that, "to date CFTC staff has been unable to find any reliable economic analysis to support either the contention that excessive speculation is affecting the market we regulate or that position limits will prevent excessive speculation." Transcript of Open Meeting on the Ninth Series of Proposed Rulemakings Under the Dodd-Frank Act at 9 (Jan. 13, 2011). Dunn also shared his "fear" that "at best position limits are a cure for a disease that does not exist, or at worst it's a placebo for one that does." Id. Commissioners Jill Sommers and Scott D. O'Malia also expressed fundamental concerns with the position limits proposal before the agency. Id. at 12-15; 18-22.

In the NPRM, the CFTC proposed to establish position limits for futures contracts, options contracts and swaps for 28 physical commodities. In discussing its statutory authority, the CFTC stated its view that it was:

> not required to find that an undue burden on interstate commerce resulting from excessive speculation exists or is likely to occur in the future in order to impose position limits. Nor is the Commission required to make an affirmative finding that position limits are necessary to prevent sudden or unreasonable fluctuations

> or unwarranted changes in prices or otherwise necessary for market protection. Rather the Commission may impose position limits prophylactically, based on its reasonable judgment that such limits are necessary for the purpose of 'diminishing, eliminating, or preventing' such burdens on interstate commerce . . . .

76 Fed. Reg. at 4754 (emphasis added). The CFTC stated that the "basic statutory mandate in section [6]a of the Act to establish position limits to prevent 'undue burdens' associated with 'excessive speculation' has remained unchanged—and has been reaffirmed by Congress several times—over the past seven decades." Id. In discussing the Dodd-Frank amendments to Section 6a, the Commission noted that:

> [P]ursuant to the Dodd-Frank Act, Congress significantly expanded the Commission's authority and mandate to establish position limits beyond futures and options contracts to include, for example, economically equivalent derivatives. Congress expressly directed the Commission to set limits in accordance with the standards set forth in sections [6]a(a)(1) and [6]a(a)(3) of the Act, thereby reaffirming the Commission's authority to establish position limits as it finds necessary in its discretion to address excessive speculation.

Id. at 4755 (emphasis added). At this stage of the rulemaking, therefore, when discussing the "standards set forth in section [6]a(a)(1)," the Commission directly referred to its authority to "establish position limits as it finds necessary in its discretion to address excessive speculation." Id.

The Final Rule

During an open meeting on October 18, 2011, the CFTC adopted the Position Limits Rule by a vote of 3 to 2. 76 Fed. Reg. at 71,699. Chairman Gary Gensler and Commissioner Bart Chilton voted in favor of the Rule, with Commissioner Dunn providing the third vote for the majority. (Dkt. No. 31 at 10-11); 76 Fed. Reg. at 71,699. Dunn stated that "no one has presented this agency any reliable economic analysis to support either the contention that excessive speculation is affecting the market we regulate or that position limits will prevent the excessive speculation." Transcript of Open Meeting on Two Final Rule Proposals Under the Dodd-Frank Act (hereinafter "10/18/11 Tr. at __") at 13 (Oct. 18, 2011). Dunn expressed his opinion that "position limits may harm the very markets we're intending to protect." Id. at 14. Despite the fact that his opinion on position limits still "ha[d] not changed," Dunn voted in favor of the Rule because he believed Congress had required the Commission to impose position limits:

> Position limits are, in my opinion, a sideshow that has unnecessarily diverted human and fiscal resources away from actions to prevent another financial crisis. To be clear, no one has proven that the looming specter of excessive speculation in the futures market re-regulated even exist, let alone played any role whatsoever in the financial crisis of 2008. Even so, Congress has tasked the CFTC with preventing excessive speculation by imposing position limits. This is the law. The law is clear, and I will follow the law.

10/18/11 Tr. at 11, 13 (emphasis added).

Commissioner Gensler supported Commissioner Dunn's view, stating that by "the Dodd-Frank Act, Congress mandated that the CFTC set aggregate position limits for certain physical commodity derivatives." 76 Fed. Reg. at 71,626, 71,699. The final rule reflected the Commission's view that it was compelled to produce a certain result: "Congress did not give the Commission a choice. Congress directed the Commission to impose position limits and to do so expeditiously." 76 Fed. Reg. at 71,628 (emphasis added).

Commissioners Sommers and O'Malia voted against the final rule and published written dissents. Sommers claimed that, while she was not philosophically opposed to position limits, she did "not believe position limits will control prices or market volatility" in this market. 76 Fed. Reg. at 71,699. Sommers claimed that the rule would inflict the greatest harm on bona fide hedgers and "ironically" may "result in increased food and energy costs for consumers." Id. Sommers claimed that, in her view, the Commission had "chosen to go way beyond what is in the statute and have created a very complicated regulation that has the potential to irreparably harm these vital markets." 76 Fed. Reg. at 71,700. By enacting the Rule, she believed that "[the CFTC] is setting itself up for an enormous failure." 76 Fed. Reg. at 71,699.

Commissioner O'Malia claimed that, although he had a number of serious concerns about the Rule, his "principal disagreement is with the Commission's restrictive interpretation of the statutory mandate under Section 4a [7 U.S.C. § 6a] of the [CEA] to establish position limits without making a determination that such limits are necessary and effective in relation to the identifiable burdens of excessive speculation on interstate commerce." Id. at 71,700 (emphasis added). As O'Malia stated, "the Commission ignores the fact that in the context of the Act, such discretion is broad enough to permit the Commission to not impose limits if they are not appropriate." Id. at 71,701. In O'Malia's view, the CFTC had "fail[ed] to comply with Congressional intent" and "misse[d] an opportunity to determine and define the type and extent of speculation that is likely to cause sudden, unreasonable and/or unwarranted commodity price movements so that it can respond with rules that are reasonable and appropriate." Id. at 71,700. O'Malia also faulted the Commission for promulgating the rule without any evidence that the position limits would actually benefit the market:

- "Historically, the Commission has taken a much more disciplined and fact-based approach in considering the question of position limits; a process that is lacking from the current proposal." Id. at 71,700.

- "The Commission voted on this multifaceted rule package without the benefit of performing an objective factual analysis based on the necessary data to determine whether these particular limits . . . will effectively prevent or deter excessive speculation." Id. at 71,702.

- "By failing to put forward data evidencing that commodity prices are threatened by the negative influence of a defined level of speculation that we can define as 'excessive speculation,' and that today's measures are appropriate (i.e. necessary and effective) in light of such findings, I believe that we have failed under the Administrative Procedure Act to provide a meaningful and informed opportunity for public comment." Id.

In the Position Limits Rule, the CFTC established spot-month and non-spot-month position limits for all "Referenced Contracts" as defined under the Rule. (Dkt. No. 31 at 13). A Referenced Contract:

> is defined as a Core Referenced Futures Contract or a futures contract, options contract, swap or swaption directly or indirectly linked to either the price of a Core Referenced Futures Contract or to the price of the commodity underlying a Core Referenced Futures Contract for delivery at the same location as the commodity underlying the relevant Core Referenced Futures Contract.

Id. (internal quotation marks omitted). The Rule identifies 28 Core Referenced Futures Contracts that will be subject to its provisions. Id. The Rule specifies that spot-month position limits shall be based on one-quarter of the estimated spot month deliverable supply as established by the Commission, and will apply to both physical delivery and cash-settled contracts separately. Id. at 14. For non-spot-months, different position limit rules apply for legacy Referenced Contracts and non-legacy Referenced Contracts. Id. at 15. Legacy Referenced Contracts are contracts that were previously subject to position limits by the CFTC. Id. These contracts will remain subject to the preexisting regulations set forth in 17 C.F.R. § 150, although the Rule raised the preexisting limits to higher levels. Id.

Non-legacy Referenced Contracts are contracts that were not previously subject to position limits. Id. The position limits for these contracts are fixed by the Commission based on "10 percent of the first 25,000 contracts of average all-months combined aggregated open interest with a marginal increase of 2.5 percent thereafter." Id. In addition to these regulations, the Rule also established circumstances where a trader must aggregate positions held in multiple accounts. Id. at 16. Subject to some exceptions, traders must aggregate all counts in which they have at least a 10% ownership or equity interest. Id.

Claims

Plaintiffs assert the following claims against the CFTC based on the Position Limits Rule: 1) Count One: Violation of the CEA and APA—Failure to Determine the Rule to be Necessary and Appropriate under 7 U.S.C. § 6a(a)(1), (a)(2)(A), (a)(5)(A)); 2) Count Two: Violation of the CEA—Insufficient Evaluation of Costs and Benefits under 7 U.S.C. § 19(a); 3) Count Three: Violation of the APA—Arbitrary and Capricious Agency Action in Promulgating the Position Limits Rule; 4) Count Four: Violation of the APA—Arbitrary and Capricious Agency Action in Establishing Specific Position Limits and Adopting Related Requirements and Restrictions; 5) Count Five: Violation of the APA—Failure to Provide Interested Persons A Sufficient Opportunity to Meaningfully Participate in the Rulemaking; and 6) Count Six: Claim for Injunctive Relief.

ANALYSIS

I. Standard of Review

When ruling on a summary judgment motion in a case involving final review of an agency action under the APA, the standards of Federal Rule of Civil Procedure 56(c) do not apply because of the limited role of the court in reviewing the administrative record.[3] See

[3] Local Rule 7(h)(1) requires that a party moving for summary judgment attach a Statement of Undisputed Facts. In cases where judicial review is based solely on the administrative record, however, a Statement of Undisputed Facts is not required. LCvR 7(h)(2). In those cases, "motions for summary judgment and oppositions thereto shall include a statement of facts with references to the administrative record." Id. Thus, this Opinion will cite to either the statement of facts accompanying parties' motions which cite to the administrative record or to the record itself.

Charter Operators of Alaska v. Blank, 844 F. Supp. 2d 122, 126-27 (D.D.C. 2012). Summary judgment serves as a mechanism for deciding, as a matter of law, whether the administrative record supports the agency action and whether the agency action is consistent with the APA standard of review. See Richards v. INS, 554 F.2d 1173, 1177 & n.28 (D.C. Cir. 1977). The district court must "review the administrative record to determine whether the agency's decision was arbitrary and capricious, and whether its findings were based on substantial evidence." Forsyth Memorial Hosp., Inc. v. Sebelius, 639 F.3d 534, 537 (D.C. Cir. 2011) (citing Troy Corp. v. Browner, 120 F.3d 277, 281 (D.C. Cir. 1997)).

II. The Parties' Arguments Regarding the Interpretation of the Dodd-Frank Amendments

This case largely turns on whether the CFTC, in promulgating the Position Limits Rule, correctly interpreted Section 6a as amended by Dodd-Frank. Although both sides forcefully argue that the statute is clear and unambiguous, their respective interpretations lead to two very different results: one which mandates the Commission to set position limits without regard to whether they are necessary or appropriate, and one which requires the Commission to find such limits are necessary and appropriate before imposing them.

Plaintiffs argue that Section 6a is clear and unambiguous, and that the statute required the CFTC to make statutorily-required findings of necessity prior to promulgating the Position Limits Rule. (Dkt. No. 31 at 18-19). Plaintiffs argue that the CFTC misinterpreted the plain text of Dodd-Frank to mean that the CFTC must impose position limits without regard to whether such limits were appropriate or necessary. Plaintiffs argue that the statutory requirement included an obligation to determine whether specific position limits and the specific commodities to which they were tied were necessary and appropriate. (Dkt. No. 14 at 19).

Plaintiffs point out that, under Section 6a(a)(1), the CFTC has the discretion to establish position limits from time to time "as the Commission finds are necessary to diminish, eliminate, or prevent" the burden on interstate commerce caused by excessive speculation. (Id. at 19). Under Plaintiffs' view, that necessity standard applies to any position limits set pursuant to Dodd-Frank because the Dodd-Frank amendments expressly incorporate that standard. See § 6a(a)(2) (stating that position limits shall be established "[i]n accordance with the standards set forth in paragraph (1) of this subsection . . . ."); (Dkt. No. 31 at 20-21).

Plaintiffs also argue that the CFTC failed to find that it was appropriate to set position limits, in violation of the clear language of Sections 6a(a)(2) and (a)(5). See §§ 6a(a)(2)(A) ("the Commission shall by rule, regulation, or order establish limits on the amount of positions, as appropriate . . . that may be held by any person . . . .") (emphasis added); 6a(a)(5) ("the Commission shall establish limits on the amount of positions, including aggregate position limits, as appropriate, . . .) (emphasis added). Plaintiffs argue that the "as appropriate" clauses in Sections 6a(a)(2) and (a)(5) modify "shall," thus imposing a requirement on the CFTC that it shall only set limits if the Commission finds it "appropriate" to do so.

Finally, Plaintiffs argue that the CFTC's interpretation of the statute is internally inconsistent. By imposing position limits for contracts related to only certain (and not all) commodities, the Commission "acknowledged that it had the discretion to establish position limits for some commodity contracts and not others." (Dkt. No. 14 at 23). As Plaintiffs point out, however, the text of Section 6a "nowhere distinguishes between different commodities." (Dkt. No. 14 at 23; Dkt. No. 31 at 22); 76 Fed. Reg. at 71,665. Plaintiffs argue that "if, as the Commission concedes, the statute does not require the Commission to establish position limits for all commodities, there is no textual basis to conclude that it is required to regulate any of them." (Dkt. No. 14 at 23). Because there is no dispute that the CFTC failed to find that the imposition of position limits was necessary and appropriate, Plaintiffs ask this Court to vacate and remand the Rule to the agency.

For its part, the Commission also argues that Section 6a is clear and unambiguous. The Commission, however, takes the unwavering position that Congress mandated the agency to set position limits and stripped it of all discretion not to impose limits. The CFTC argues that it was not required to find that position limits were necessary or appropriate before imposing them and that, by adding Sections 6a(a)(2)-(7), Congress made the imposition of speculative limits mandatory. (Dkt. No. 25 at 20-23). Specifically, the CFTC points out that Congress stated that "with respect to physical commodities . . . the Commission shall by rule, regulation or order establish limits on the amounts of positions, as appropriate, . . . that may be held by any person . . ." § 6a(a)(2)(A); (Dkt. No. 25 at 24).

The Commission also argues that Congress referred to the position limits as "required" and imposed time limits on the agency under Sections 6a(a)(2)(B)(i) (". . . the limits required under subparagraph (A) shall be established within 180 days . . ." and 6a(a)(2)(B)(ii) (". . . the limits required under subparagraph (A) shall be established within 270 days . . ."), further reflecting the fact that the Dodd-Frank amendments were a mandate to set position limits. The CFTC points to other mandatory language to support its view, including Sections 6a(a)(2)(C) ("in establishing the limits required under subparagraph (A) . . .") and 6a(a)(3) ("in establishing the limits required in paragraph (2), the Commission, as appropriate, shall set limits . . . ."). According to the CFTC, if Congress intended for the CFTC to establish limits on a case-by-case basis, it would not have required that the limits be imposed on such short deadlines. Moreover, the CFTC argues that, under Plaintiffs' view, the Dodd-Frank amendments to Section 6a would be rendered meaningless.

Finally, the CFTC argues that, under Dodd-Frank, Congress directed the Commission to "conduct a study of the effects (if any) of the position limits imposed . . . within 12 months after the imposition of the limits." Congress further directed that the Commission "shall" submit a copy of that report to Congress, and Congress shall conduct a hearing within 30 days. See 15 U.S.C. § 8307. According to the Commission, the reporting requirement is further evidence that the Dodd-Frank amendments compelled and mandated the Commission to set limits.

In sum, although each party believes the statute is clear and unambiguous, their respective "plain readings" compel different results. Ultimately, however, this Court need not choose between the competing interpretations. As explained below, Section 6a is ambiguous as to the precise question at issue: whether the CFTC is required to find that position limits are necessary and appropriate prior to imposing them. Because the Position Limits Rule is based on the CFTC's erroneous conclusion that the CEA is unambiguous on this issue, the Court "may neither defer to the agency's construction nor endorse plaintiffs' construction." See Humane Soc'y of U.S. v. Kempthorne, 579 F. Supp. 2d 7, 15 (D.D.C. 2008). Instead, the Court must remand this rule to the agency.

III. The CFTC's Interpretation of Section 6a as Amended by Dodd-Frank

a. Chevron Step One

Because this case involves the CFTC's interpretation of a statute it is charged with implementing, this Court applies the two-part test of Chevron U.S.A. Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837 (1984). See Peter Pan Bus Lines, Inc. v. Fed. Motor Carrier Safety Admin., 471 F.3d 1350, 1353 (D.C. Cir. 2006). Under step one of the Chevron test, the Court first must consider "whether Congress has directly spoken to the precise question at issue." Pub. Citizen v. Nuclear Regulatory Comm'n, 901 F.2d 147, 154 (D.C. Cir. 1990) (quoting Chevron, 467 U.S. at 842). If so, the Court and the agency "must give effect to the unambiguously expressed intent of Congress." Arizona v. Thompson, 281 F.3d 248, 253 (D.C. Cir. 2002) (quoting Chevron, 467 U.S. at 842–43); see also Northeast Hosp. Corp. v. Sebelius, 657 F.3d 1, 4 (D.C. Cir. 2011) (citing Chevron, 467 U.S. at 842–43).

Under Chevron Step One, the Court examines the statute de novo, employing traditional tools of statutory construction. Nat'l Ass'n of Clean Air Agencies v. EPA, 489 F.3d 1221, 1228 (D.C. Cir. 2007). The Court must assess the statutory text at issue, the statute as a whole, and review legislative history where appropriate. Coal Employment Project v. Dole, 889 F.2d 1127, 1131 (D.C. Cir. 1989) (citing K Mart Corp. v. Cartier, Inc., 486 U.S. 281 (1988) and Ohio v. U.S. Dep't of the Interior, 880 F.2d 432, 441 (D.C. Cir. 1989)). "This inquiry using the traditional tools of construction may be characterized as a search for the plain meaning of the statute. If this search yields a clear result, then Congress has expressed its intention as to the question, and deference [to the agency's interpretation] is not appropriate." Bell Atl. Tel. Co. v. FCC, 131 F.3d 1044, 1047 (D.C. Cir. 1997) (citing Hammontree v. NLRB, 894 F.2d 438, 441 (D.C. Cir. 1990)).

If, however, the statute is silent or ambiguous, the Court moves on to Chevron Step Two and defers to the agency's interpretation if it is based on a permissible construction of the statute. Peter Pan, 471 F.3d at 1353 (internal quotation marks and citations omitted). "A statute is considered ambiguous [under Chevron] if it can be read more than one way." Am. Fed'n of Labor & Cong. of Indus. Org. v. Fed. Election Comm'n, 333 F.3d 168, 173 (D.C. Cir. 2003) (citing United States v. Nofziger, 878 F.2d 442, 446-47 (D.C. Cir. 1989)). "Because the judiciary functions as the final authority on issues of statutory construction, an agency is given no deference at all on the question whether a statute is ambiguous." Wells Fargo Bank, N.A. v. Fed. Deposit Ins. Corp., 310 F.3d 202, 205-06 (D.C. Cir. 2002) (internal citations and quotation marks omitted).

i. Section 6a(a)(1) Plainly Requires the CFTC to Find That Position Limits are Necessary.

The first question for the Court is whether Section 6a(a)(1) requires the Commission to find that position limits are necessary prior to imposing them. This is important, of course, because the so-called "mandate" of Dodd-Frank in Section 6a(a)(2) expressly incorporates the "standards" of paragraph (1). The relevant portion of Section 6a(a)(1) states:

> For the purpose of diminishing, eliminating, or preventing such burden, the Commission shall, from time to time, after due notice and opportunity for hearing, by rule, regulation, or order, proclaim and fix such limits on the amounts of trading which may be done or positions which may be held by any person . . . under contracts of sale of such commodity for future delivery on or subject to the rules of any contract market or derivatives transaction execution facility, or swaps traded on or subject to the rules of a designated contract market or a swap execution facility, or swaps not traded on or subject to the rules of a designated contract market or a swap execution facility that performs a significant price discovery function with respect to a registered entity, as the Commission finds are necessary to diminish, eliminate, or prevent such burden.

§ 6a(a)(1) (emphasis added).

The Commission does not argue—nor could it—that this section standing alone strips the agency of any discretion not to set position limits if it would be unnecessary to do so. In fact, the statute expressly directs the agency to set position limits "from time to time." Id. The precise question, therefore, is whether the language of Section 6a(a)(1) clearly and unambiguously requires the Commission to make a finding of necessity prior to imposing position limits. The answer is yes.

The contested language in Section 6a(a)(1) has remained largely unchanged from the initial passage of the CEA to the Dodd-Frank amendments. Compare Pub. L. No. 74-675, ch. 545, 49 Stat. 1491, 1492 (June 15, 1936) ("For the purpose of diminishing, eliminating, or preventing such burden, the commission shall, from time to time . . . proclaim and fix such limits on the amount of trading . . . which may be done by any person as the commission finds is necessary to diminish, eliminate or prevent such burden.") (emphasis added) with Pub. L. No. 111-203, Title VII, § 737(a) to (c), 124 Stat. 1722 (July 21, 2010) ("For the purpose of diminishing, eliminating, or preventing such burden, the Commission shall, from time to time . . . proclaim and fix such limits on the amounts of trading which may be done or positions which may be held by any person . . . as the Commission finds are necessary to diminish, eliminate, or prevent such burden.") (emphasis added).[4]

Consistent with this longstanding requirement, the Commission made necessity findings in its rulemakings establishing position limits for 45 years after the passage of the CEA. See In the Matter of Limits on Position and Daily Trading in Wheat, Corn, Oats, Barley, Rye and Flaxseed for Future Delivery, 3 Fed. Reg. 3145, 3146 (Dec. 24, 1938) ("[T]rading in any one grain for future delivery on a contract market, by a person who holds or controls a speculative net position of more than 2,000,000 bushels, long or short in any one future or in all futures combined in such grain on such contract market, tends to cause sudden and unreasonable fluctuations and changes in the price of such grain . . . in order to diminish, eliminate, or prevent

[4] In 1935, Congress provided an unambiguous interpretation of the phrase "as the Commission finds are necessary" in an "Explanation of the Bill": "[Section 4a of the CEA] gives the Commodity Exchange Commission the power, after due notice and opportunity for hearing and a finding of a burden on interstate commerce caused by such speculation, to fix and proclaim limits on futures trading. . . ." H.R. Rep. 74-421, at 5 (1935) (emphasis added). This text clearly indicates that Congress intended for the CFTC to make a "finding of a burden on interstate commerce caused by such speculation" prior to enacting position limits.

the undue burden of excessive speculation in grain futures which causes unwarranted price changes, it is necessary to establish limits on the amount of speculative trading under contracts of sale of grain for future delivery on contract markets, which may be done by any one person.") (emphasis added); see also In the Matter of Limits on Position and Daily Trading in Cotton for Future Delivery, 5 Fed. Reg. 3,198 (Aug. 28, 1940); Limits on Position and Daily Trading in Eggs for Future Delivery, 16 Fed. Reg. 8,106 (Aug. 16, 1951); Limits on Position and Daily Trading in Cottonseed Oil for Future Delivery, 18 Fed. Reg. 443 (Jan. 22, 1953); Limits on Position and Daily Trading in Soybean Oil for Future Delivery, 18 Fed. Reg. 444 (Jan. 22, 1953); Limits on Position and Daily Trading in Lard for Future Delivery, 18 Fed. Reg. 445 (Jan. 22, 1953); Limits on Position and Daily Trading in Onions for Future Delivery, 21 Fed. Reg. 5,575 (July 25, 1956).

The CFTC argues that, although it made necessity findings in these prior rulemakings, the agency never stated that a finding of necessity was required. (Dkt. No. 38 at 19, n.12). This argument is without merit. The plain text of the statute requires that position limits be set "as the Commission finds are necessary to diminish, eliminate, or prevent [excessive speculation]." § 6a(a)(1). The text does not state (nor has it ever) that the CFTC may do away with or ignore the necessity requirement in its discretion. There is no ambiguity as to whether the statute requires the CFTC to make such findings, and the CFTC has never apparently treated the statute as ambiguous on this point. Accordingly, the Court concludes that § 6a(a)(1) unambiguously requires that, prior to imposing position limits, the Commission find that position limits are necessary to "diminish, eliminate, or prevent" the burden described in Section 6a(a)(1).

ii. The Commission's Arguments That Section 6a(a)(1) Does Not Require a Necessity Finding Are Unavailing.

For 45 years after the passage of the CEA, the CFTC made necessity findings prior to imposing position limits under Section 6a(a). The CFTC has not cited to any express interpretation in which the CFTC took the position that no necessity finding was required. Nor has the CFTC cited to any prior interpretation in which the CFTC took the position that the specific language of Section 6a(a) (now Section 6a(a)(1)) was ambiguous on this point. Fully aware that Section 6a(a)(1) is problematic for its current position, the CFTC makes a number of arguments in an attempt to get out from underneath the statute's plain language requiring a necessity finding. Notwithstanding the CFTC's various—and at times inconsistent interpretations, the necessity requirement remains in Section 6a(a)(1).

"Necessary" Only Modifies the "Amounts of Trading"

First, in its Opposition to Plaintiffs' Motion for Preliminary Injunction, the CFTC argued that, because "necessary" is more closely preceded by the phrase "proclaim and fix such limits on the amounts of trading," it is "far more plausible" to interpret this provision as requiring the Commission only to find that amounts of trading were necessary, not that limits in general are necessary. (Dkt. No. 25 at 24). The Commission has wisely abandoned this interpretation on summary judgment. The plain language of § 6a(a)(1) and the Commission's position limits rulemakings since 1936 undermine this strained interpretation.

The Dodd-Frank Amendments "Converted" Section 6a(a)(1)

At oral argument on Plaintiffs' Motion for Preliminary Injunction, the Commission offered another argument in support of its view that no necessity finding was required. In discussing the Dodd-Frank amendments of Sections 6a(a)(2)-(7), the Commission argued that "those amendments basically converted the authorization in 6a(1)." 2/27/12 Tr. at 26. In other words, the Commission stated that its "primary argument is you have to look at that language, the language in the Dodd-Frank amendments, to see how the authorization that was always there to the commission to put position limits in place, and which, in the exercise of its judgment, became a mandate in 2010." Id. There is nothing in the plain language of the statute, however, that supports the Commission's argument that the discretion in Section 6a(a)(1) was somehow "converted" by Dodd-Frank. If anything, the Dodd-Frank amendments are subject to the preexisting standards of Section 6a(a)(1), not the other way around. See § 6a(a)(2)(A) ("In accordance with the standards set forth in paragraph (1) of this subsection. . . . ").

Section 6a(a)(1) Imposes No Substantive Requirements on the Commission

Now, on summary judgment, the Commission argues that the "necessary" language actually imposes no substantive requirement at all. (Dkt. No. 38 at 19). Seemingly inconsistent with its earlier position that Section 6a(a)(1) requires the CFTC to find only that the actual "amounts of trading" are "necessary," the Commission argues that the language only means that this Court must afford deference to the CFTC to "make a judgment," and that any action the agency takes must be "rationally related to the purpose of the statute or its specific provisions." (Dkt. No. 38 at 19) (relying principally on Mourning v. Family Publications Service, Inc., 411 U.S. 356 (1973)). Again, the CFTC's argument is without merit. First, the Court must give effect to the meaning of each word of the statute, which states that the Commission shall impose limits as the agency "finds are necessary." § 6a(a)(1). Moreover, the language of Section 6a(a)(1) is more limited and tied to a more specific objective than the general empowering provision that was at issue in Mourning. See Mourning, 411 U.S. at 361-62 (stating that Federal Reserve Board shall prescribe regulations "as in the judgment of the Board are necessary or proper to effectuate the purposes of [the Act]. . . ."); see also AFL-CIO v. Chao, 409 F.3d 377, 384 (D.C. Cir. 2005). In any event, Mourning has been interpreted by courts in our Circuit to apply during the Chevron Step Two analysis, and that the Court's deference to the agency is still limited by the particular language of a statute at issue. See AFL-CIO, 409 F.3d at 384; Colorado River Indian Tribes v. Nat'l Indian Gaming Comm'n, 383 F. Supp. 2d 123, 144 (D.D.C. 2005).

In relying on Mourning, it appears that the Commission is confusing two different issues with respect to Section 6a(a)(1). Section 6a(a)(1) contains a clear statutory requirement that the CFTC find that any position limits "are necessary to diminish, eliminate, or prevent" the burden on interstate commerce described in the statute. That point is wholly different from whether any particular rule, regulation or order is "necessary to diminish, eliminate or prevent such burden." Whether Section 6a(a)(1) requires such a finding is clear and unambiguous. Whether any particular regulation setting position limits is actually "necessary to diminish, eliminate or prevent such burden" is not before this Court because the CFTC has taken the position that it is not required to make that finding.

The distinction between these two questions is illustrated in the D.C. Circuit's opinion in AFL-CIO v. Chao. In that case, the Circuit considered whether the Secretary of Labor exceeded her authority when she promulgated a rule under 29 U.S.C. § 438, which states that: "[t]he Secretary shall have authority to issue, amend, and rescind . . . such . . . reasonable rules and regulations . . . as [s]he may find necessary to prevent the circumvention or evasion of [Title II's] reporting requirements." 29 U.S.C. § 438 (emphasis added); AFL-CIO, 409 F.3d at 386. The Circuit asked whether the specific rule at issue "comport[ed] with the statutory requirements that the Secretary 'find [the rule] necessary to prevent' evasion of reporting requirements." AFL-CIO, 409 F.3d at 386 (quoting 29 U.S.C. § 438) (emphasis added). Because the Circuit found the word "necessary" to be inherently ambiguous, the Circuit proceeded under Chevron Step Two to review with deference whether the "Secretary's interpretation of "what is 'necessary'" as embodied in the rule was "limited to preventing such circumvention or evasion," as set forth in the governing statute. Id. at 387. In so doing, the Circuit referred on numerous instances to the fact that the "plain text" of the statute "limits the Secretary's authority with respect to trust reporting." Id. at 390. The Circuit also noted that the statute "required" a "determination" that the rule was "necessary to prevent union circumvention or evasion of Title II reporting requirements." Id. at 389 (emphasis added). Moreover, although then-Circuit Judge Roberts dissented in part to the majority opinion, he nevertheless agreed that the statute required the Secretary to make necessity findings: ". . . the Secretary has not so found, much less made a determination that such a report would be necessary to prevent circumvention or evasion of union reporting requirements. Our dissenting colleague acknowledges the Secretary must make such findings." Id. at 390 (emphasis added).

Ultimately, the Circuit held that the Secretary had exceeded her authority under the statute because the rule "reache[d] information unconnected to the circumvention or evasion of union Title II reporting requirements." Id. Thus, although the Secretary was entitled to deference under Chevron Step Two as to whether the specific rule promulgated was "necessary" to meet the specific purpose of the statute, what was not ambiguous was that there was a "statutory requirement" that she must "make such findings." Id. For precisely these reasons, this Court is not persuaded by the CFTC's argument that Section 6a(a)(1) imposes no "substantive" requirements on the agency.

The CFTC's 1981 Rulemaking Renders the Necessity Finding Unnecessary

Finally, relying on a 1981 rulemaking, the CFTC asks this Court to accept its argument that the Commission is no longer required to make a finding that position limits are necessary prior to imposing them. The CFTC attempts to validate its interpretation in two ways. First, the

CFTC argues that its interpretation of Section 6a(a)(1) doing away with a necessity finding is entitled to Chevron deference. (Dkt. No. 38 at 18, n.10; Dkt. No. 55 at 6, n.4). Second, the Commission argues that Congress ratified its interpretation and, therefore, the Commission is no longer required to make a necessity finding as it did numerous times between 1936 and 1981.

As set forth above, the language of Section 6a(a)(1) is clear and unambiguous regarding the Commission's duty to make a necessity finding. Accordingly, the CFTC's interpretation of the statute is not entitled to any Chevron deference, particularly where the agency has never treated the statute as ambiguous. See Arizona, 281 F.3d at 253 (quoting Chevron, 467 U.S. at 842–43 for the proposition that if the language of the statute is clear, the court and agency "must give effect to the unambiguously expressed intent of Congress.").

Moreover, Congress has not ratified any CFTC interpretation of 6a(a)(1) doing away with the necessity finding requirement. The CFTC argues that, in its 1981 rulemaking, it changed its interpretation of Section § 6a(a) to allow for the establishment of position limits without a finding of necessity. (Dkt. No. 38 at 19). The CFTC relies on the fact that, in that rulemaking, the CFTC required exchanges to establish position limits for all futures contracts for which there were not already limits. (Id. at 20). In doing so, the CFTC did not require exchanges to make a finding that excessive speculation was a problem or that position limits were the correct solution. Id. The CFTC also cites to the rule's preamble which states that "Section 4a(1) represents an express Congressional finding that excessive speculation is harmful to the market, and a finding that speculative limits are an effective prophylactic measure." Establishment of Speculative Position Limits, 46 Fed. Reg. 50,938, 50,940 (Oct. 16, 1981). The CFTC argues that Congress ratified the CFTC's interpretation of § 6a(a) when it amended the CEA in 1982 without overturning the CFTC's construction of the statute. (Dkt. No. 38 at 20-21).

The CFTC takes a roundabout route to ratification, and one that this Court declines to follow. The CFTC has not offered any longstanding agency interpretation that abrogated the agency's duty to make necessity findings under § 6a(a)(1). Nothing that the CFTC relies on in the 1981 rulemaking speaks directly to the interpretation of § 6a(a)(1) that CFTC now advances in this case. Moreover, the 1981 interpretation that the CFTC does cite—that the statute allows the agency to prophylactically impose position limits and that the CFTC need not find that excessive speculation actually exists beforehand—does not appear to be in dispute in this case. This authority is squarely in the plain text of Section 6a. See § 6a(a)(1) (stating that the CFTC has the authority to set position limits "as the Commission finds are necessary to diminish, eliminate, or prevent [excessive speculation].") (emphasis added). Moreover, Plaintiffs do not appear to contest that the CFTC may impose position limits prophylactically, "so long as it makes an informed determination that there is a reasonable likelihood that excessive speculation will pose a problem in a particular market, and that position limits are likely to curtail it without imposing undue costs." (Dkt. No. 45 at 2). As Plaintiffs correctly note, "[w]hat the plain language of Section 6a(a)(1) does not permit is the establishment of position limits—whether prophylactic or remedial without any necessity finding at all." (Id.).

The fact that the CFTC did not make a necessity finding in its 1981 rulemaking does not constitute an interpretation from which this Court can infer congressional ratification. See Autolog Corp. v. Regan, 731 F.2d 25, 32 (D.C. Cir. 1984) ("When an agency interpretation has been officially published and consistently followed, Congress is presumed to be aware of the administrative interpretation of a statute and to adopt that interpretation when it re-enacts a statute without change.") (emphasis added) (internal citations and quotation marks omitted).[5] To accept the agency's argument now, this Court would have to find that Congress ratified by silence an interpretation of Section 6a(a)(1) that the CFTC made by silence. The Court simply cannot draw such a conclusion on this record.

iii. Sections 6a(a)(2), (a)(3) and (a)(5) are ambiguous

Although the CFTC seeks Chevron deference as to its reading of Section 6a(a)(1), the CFTC "is not claiming deference with respect to Congress' mandate (which comes from the Dodd-Frank amendments, sections 6a(a)(2)-(7))." (Dkt. No. 55 at 6, n.4). Upon a review of the entire amended Section 6a, the Court cannot hold that the Dodd-Frank amendments in sections 6a(a)(2), (a)(3) and (a)(5) constitute a clear and unambiguous mandate.

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5 It appears that the Commission has not even consistently followed its purported 1981 interpretation abrogating the statutory requirement of finding necessity. In its Cross-Motion for Summary Judgment, the CFTC admits that "[f]or a period of time beginning in the 1990s until the passage of Dodd-Frank, the Commission took a different approach . . . allowing exchanges to substitute trader reporting obligations for fixed limits." (Dkt. No. 38 at 7). By permitting some exchanges to set position accountability levels in lieu of position limits the CFTC was making a conclusion that position limits were not necessary for those exchanges. In addition, in 2001, the CFTC promulgated a rule providing guidance for boards of trade designated as contract markets on how to comply with the Core Principles listed in 7 U.S.C. § 7. See A New Regulatory Framework for Trading Facilities, Intermediaries and Clearing Organizations, 66 Fed. Reg. 42,256 (Aug. 10, 2001). Core Principle 5 provides the following: "To reduce the potential threat of market manipulation or congestion (especially during trading in the delivery month), the board of trade shall adopt for each contract of the board of trade, as is necessary and appropriate, position limitations or position accountability for speculators." 7 U.S.C. § 7(d)(5)(A). The CFTC, in providing guidance on compliance with Core Principle 5, stated, "In general, position limits are not necessary for markets where the threat of excessive speculation or manipulation is nonexistent or very low." 17 C.F.R. § 38 app. B (Core Principle 5) (effective August 10, 2001 until August 20, 2012); 66 Fed. Reg. at 42,280. The CFTC has only recently repealed this provision in a final rulemaking issued on June 19, 2012. See Core Principles and Other Requirements for Designated Contract Markets, 77 Fed. Reg. 36,612, 36,718 (June 19, 2012).

As Plaintiffs point out, the CFTC has offered no meaningful explanation for how either of these two rules "could possibly comport with its supposed 1981 view that Congress, in Section 6a(a)(1), had already determined that excessive speculation exists in all markets and that position limits were always effective to combat it." (Dkt. No. 45 at 5).

1. "In accordance with the standards set forth in paragraph (1)"

First, it is wholly unclear to what extent the CFTC's authority in Section 6a(a)(2) is dependent on the statutory requirement in subsection 6a(a)(1) that the agency find position limits "necessary." The very first clause of Section 6a(a)(2) begins "[i]n accordance with the standards set forth in paragraph (1) of this subsection . . . the Commission shall by rule, regulation, or order establish limits on the amount of positions . . . ." Section § 6a(a)(2) (emphasis added). It is clear that Congress incorporated and directed the agency to set any limits in Section 6a(a)(2) "in accordance with the standards" of the CFTC's existing authority in Section 6a(a)(1). What is unclear, however, is what "standards" Congress meant to govern any limits set pursuant to Section 6a(a)(2).

The CFTC argues that the term "standards" in Section 6a(a)(2) does not refer to the "necessary" standard of paragraph (1), but rather the so-called aggregation standards to "positions held and trading done by any persons directly or indirectly controlled by such person . . . ." § 6a(a)(1); (Dkt. No. 38 at 24). The CFTC argues that its reading is consistent with the "first relevant dictionary definition" of "standard" as "something set up and established by authority as a rule for the measure of quantity, weight, extent, value, or quality." Id. at 24-25 (citing Merriam-Webster's Third Collegiate Dictionary 1216 (11th ed. 2011)).

The CFTC's argument is unavailing. First, the term "standard" or "standards" does not appear anywhere in Section 6a(a)(1). Thus, there is no clear indication of the specific "standards" to which Congress referred. Second, the CFTC's selective reading of subsection (a)(1) renders any language but the supposed aggregation standards mere surplusage. See Humane Soc'y, 579 F. Supp. 2d at 16 ("But this reading of Section 1533(a)(1)—a reading that emphasizes one part of the provision and ignores the others—is hardly the only plausible one.")

(citing United States v. Villanueva-Sotelo, 515 F.3d 1234, 1237 (D.C. Cir. 2008)). It is just as plausible that the standards to which Congress referred were those directing the Commission to set position limits only "as the Commission finds are necessary to diminish, eliminate, or prevent such burden." § 6a(a)(1). This interpretation would be consistent with other equally-applicable dictionary definitions of the term "standards." See Webster's Third New International Dictionary 2223 (1981) (defining "standard" as "something that is established by authority, custom, or general consent as a model or example to be followed."); see also Black's Law Dictionary 1535 (9th ed. 2009) ("A model accepted as correct by custom, consent, or authority"). In any event, our Circuit has warned against relying solely on dictionary definitions, as the CFTC urges, because "citing to dictionaries creates a sort of optical illusion, conveying the existence of certainty—or 'plainness'—when appearance may be all there is.'" Ctr. For Individual Freedom v. Van Hollen, No. 12-5117, slip. op. at 4 (D.C. Cir. Sept. 18, 2012) (per curiam) (quoting A. Raymond Randolph, Dictionaries, Plain Meaning, and Context in Statutory Interpretation, 17 HARV. J.L. & PUB. POL'Y 71, 72 (1994)).

Finally, and most importantly, the CFTC's current position regarding the introductory clause of subsection (a)(2) is not based on any reasoned interpretation in which the CFTC engaged at the agency level. The Commission has neither pointed to-- nor can this Court locate--any interpretation of this clause in the final rule. There appears to be nothing in the final rule giving any effect to or explaining how the position limits set were "in accordance with the standards of paragraph (1)." The only reference that this Court can locate exists in the NPRM. That reference, however, suggests that the CFTC (at least initially) interpreted the introductory clause of subsection (a)(2) as Plaintiffs currently interpret it:

> Congress expressly directed the Commission to set limits in accordance with the standards set forth in sections 4a(a)(1) and

> <u>4a(a)(3) of the Act, thereby reaffirming the Commission's authority to establish position limits as it finds necessary in its discretion to address excessive speculation.</u>

76 Fed. Reg. at 4755 (emphasis added). Accordingly, at the NPRM stage, the Commission apparently viewed the contested language of Section 6a(a)(2) to refer to the CFTC's authority in subsection 6a(a)(1) "to establish position limits as it finds necessary in its discretion . . . ." Of course, the Commission was free to amend its interpretation of the statutory language by the time the final rule was adopted. It appears, however, that because the CFTC believed that Congress had compelled a particular result, the agency failed to confront or interpret this language in any way. The agency's reliance on one of many dictionary definitions of "standards" in this Court in the first instance is unpersuasive and entitled to no deference at all.

This Court is left with no clear indication of Congress' intent when it directed the Commission to set position limits in Section 6a(a)(2) "in accordance with the standards set forth in paragraph (1) of this subsection . . . ." It is unclear whether Congress: 1) intended for the CFTC to first find that any position limits promulgated under Dodd-Frank be "necessary to diminish, eliminate, or prevent" the burden on interstate commerce; 2) was solely referring to the so-called aggregation standards in (a)(1), as the CFTC suggests; 3) was referring to both the "necessary" standard and the aggregation standards; or 4) was referring to neither the "necessary" standard nor the aggregation standards. Nor does a review of the other provisions of Section 6a(a)(2) elucidate this ambiguity. As such, paragraph (a)(2) cannot be read as a clear and unambiguous mandate to set position limits without regard to any of the necessity or discretion-conferring standards of Section 6a(a)(1).

2. "As appropriate"

The parties also disagree over whether the Dodd-Frank amendments to Section 6a required the CFTC to determine that imposing position limits was "appropriate." The "as appropriate" language appears in three contested sections (emphasis added in each):

Section 6a(a)(2)(A):

> In accordance with the standards set forth in paragraph (1) of this subsection . . . the Commission shall by rule, regulation, or order establish limits on the amount of positions, as appropriate, other than bona fide hedge positions, that may be held by any person . . .

Section 6a(a)(3):

> In establishing the limits required in paragraph (2), the Commission, as appropriate, shall set limits
>
> (A) on the number of positions that may be held by any person for the spot month, each other month, and the aggregate number of positions that may be held by any person for all months; and
>
> (B) to the maximum extent practicable, in its discretion . . .

Section 6a(a)(5)(A):

> Notwithstanding any other provision of this section, the Commission shall establish limits on the amount of positions, including aggregate position limits, as appropriate, other than bona fide hedge positions . . . .

Again, each party believes the statute is clear and unambiguous. Neither party disputes that the "as appropriate" language in these sections confers discretion in the agency. The parties part ways, however, when it comes to what exactly that phrase was meant to modify. The CFTC contends that Congress meant "as appropriate" in Sections 6a(a)(2)(A) and 6a(a)(5)(A) to modify the actual levels of the limits, whereas Plaintiffs contend that "as appropriate" was meant to modify "shall." The answer, of course, is material. If Plaintiffs are correct, then the CFTC had the authority to determine that position limits were not "appropriate" at this particular time and, thus, not impose them at all.

The statute, however, is ambiguous on this point. The CFTC fails to offer any compelling authority for its argument that, because the term "as appropriate" is closer to or comes after "establish limits on the amount of positions" in subsections (a)(2) and (a)(5), the CFTC was only required to find the "amount of positions" appropriate. (Dkt. No. 25 at 24; Dkt. No. 38 at 25). In its Opposition to Plaintiffs' Motion for Preliminary Injunction, the CFTC relied on the Rule of Last Antecedent, as described in Sutherland Statutory Construction § 47:33, as support for its construction of the "as appropriate" language. (Dkt. No. 25 at 24). The CFTC's argument, however, is wrong for at least two reasons. First, a complete review of the authority upon which the CFTC relies reveals that the Rule of the Last Antecedent is not dispositive here:

> Referential and qualifying words and phrases, <u>where no contrary intention appears</u>, refer solely to the last antecedent....The rule is another aid to discovery of intent or meaning and is not inflexible and uniformly binding. Where the sense of the entire act requires that a qualifying word or phrase apply to several preceding or even succeeding sections, the word or phrase will not be restricted to its immediate antecedent. <u>Evidence that a qualifying phrase is supposed to apply to all antecedents instead of only to the immediately preceding one may be found in the fact that it is separated from the antecedents by a comma</u>.

2A N. Singer & J. Singer, SUTHERLAND STATUTORY CONSTRUCTION § 47:33 (7th ed. 2011) (hereinafter "Sutherland") (emphasis added).

In this case, the "as appropriate" clauses in (a)(2) and (a)(5) are separated from their antecedents by a comma on either side. According to Sutherland, this fact is evidence that the phrase was "supposed to apply to all antecedents instead of only to the immediately preceding one." <u>Id.</u> If that is the case, "as appropriate" modifies both "shall" in subsections 6a(a)(2) and (a)(5) as well as the "amount of positions." Moreover, unlike the traditional cases in which the

Rule of the Last Antecedent has been found to apply, the clauses in question are not part of a list. See United States v. Pritchett, 470 F.2d 455, 456, 458-59 (D.C. Cir. 1972) (holding that, in statute providing that "provisions of section 22-3204 shall not apply to marshals, sheriffs, prison or jail wardens, or their deputies, policemen or other duly appointed law-enforcement officers, or to members of the Army, Navy, or Marine Corps of the United States or of the National Guard or Organized Reserves when on duty," the phrase "on duty" modified only the last antecedent).

In their amicus brief, members of the House Democratic Conference Committee on H.R. 4173 point to legislative history of an early iteration of the Act as reflected in House Report 111-385. That language stated that "Section 6(a) requires the CFTC to set appropriate position limits for all physical commodities other than excluded commodities." (Dkt. No. 49 at 3). According to amici, this reflects that the use of the word "appropriate" in the text was intended to describe the level of the position limit, not whether the limits themselves were appropriate. (Id. at 3-4). But that is not the final language Congress used. Congress set the "as appropriate" language apart from all other clauses with commas. It could have merely, as written in the legislative history, placed the word "appropriate" before "limits" in subsections (a)(2)(A) and (a)(5). This portion of legislative history, thus, does not conclusively explain how the statute, as written, clearly indicates that the phrase "as appropriate" modifies position limits. Nor does this legislative history exclude the interpretation that the CFTC could find it appropriate to set no position limits for some commodities.

Second, the CFTC's construction of the statute as a mandate is at least partially undermined by Congress' use of the clause "as appropriate" in subsection (a)(3): "In establishing the limits required in paragraph (2), the Commission, as appropriate, shall set limits . . . ." § 6a(a)(3). Here, under the CFTC's logic, "as appropriate" is closest to the verb "shall" and, as such, modifies it. This would undermine the CFTC's position that subsection (a)(3) constituted a mandate and that the agency had no discretion not to set limits on the positions described in that subsection.

Further lending to the ambiguity is that subsection (a)(5)(A) governing "economically equivalent contracts" begins with the phrase "[n]otwithstanding any other provision of this section, the Commission shall establish limits on the amount of positions, including aggregate position limits, as appropriate, ..." § 6a(a)(5)(A). Accordingly, it would seem that—unlike subsection (a)(2)(A) in which the CFTC is bound to set limits in accordance with the "standards" of paragraph (1)—subsection (a)(5)(A) is to apparently operate free of any other provision of Section 6a. If that is the case, this would undermine the CFTC's argument that subsection (a)(2)(A) operates as a standalone mandate, as it is clear from the "notwithstanding" language in subsection (a)(5)(A) that Congress knew how to divorce subsections of Section 6a from each other. On the other hand, however, Congress still used the "as appropriate" language conferring discretion in subsection (a)(5)(A).

In short, it is wholly unclear whether Congress meant "as appropriate" in subsections (a)(2)(A), (a)(3) and (a)(5)(A) to modify the verb "shall" or other parts of those subsections. The CFTC did not recognize these ambiguities and interpret the statute accordingly in the first instance. The Court cannot conclude that the "as appropriate" clauses clearly modify the verb "shall" in each instance, nor can it conclude given traditional tools of statutory construction that "as appropriate" was meant only to grant the Commission authority to set the "amount of positions" as it saw "appropriate."

3. Section 6a(a)(6)

There appears to be no dispute that Section 6a(a)(6) is a mandate upon the Commission to set aggregate position limits in at least three circumstances. See § 6a(a)(6)(A)-(C). As Plaintiffs concede, Section 6a(a)(6) is a provision "that is not at issue in this case and that in any event does not use the key phrase 'as appropriate' or expressly incorporate the necessity standard of Section 6a(a)(1)." (Dkt. No. 45 at 10).

The Court declines, however, to reach a determination on whether the aggregation standards promulgated in the final rule are arbitrary and capricious under 5 U.S.C. § 706(2)(A) or in violation of the cost-benefit analysis requirements of 7 U.S.C. § 19. Nor is the Court in a position to determine whether the Commission's aggregation policies should stand alone severed from the final rule. The Commission has informed the Court that it has issued a Notice of Proposed Rulemaking ("Aggregation Notice") to revisit "several provisions" of the Position Limits Rule governing aggregation of speculative positions. (Dkt. Nos. 61, 63); see also Dkt. No. 63-1 (stating that, through the Aggregation Notice, CFTC is considering proposed changes to seven aggregation provisions of final rule). The CFTC apparently is considering whether to modify many of the aggregation provisions with which Plaintiffs take issue in this case. See Aggregation Position Limits for Futures and Swaps, 77 Fed. Reg. 31,767 (May 30, 2012) (proposing amendments to, among other provisions, the information sharing exemption and the 10% ownership standard). Because the aggregation rules are currently under consideration and may be changed after the Position Limits Rule goes into effect, the Commission's Division of Market Oversight also issued a "no action" letter to all market participants excusing them from compliance with certain portions of the rule under certain circumstances. (Dkt. No. 63-1).

Given that several provisions of the aggregation rules—rules which the Commission refers to as a "central feature of any position limits regime"—are under consideration and may be modified, it is not appropriate for this Court to interfere in the rulemaking at this stage. (Dkt. No. 38 at 42). Indeed, it is wholly unclear whether any challenges to the aggregation rules are even ripe at this time. See Abbott Labs. v. Gardner, 387 U.S. 136, 148-49 (1967) (prudential ripeness principles protects "the agencies from judicial interference until an administrative decision has been formalized and its effects felt in a concrete way by the challenging parties."); Ohio Forestry Ass'n Inc. v. Sierra Club, 523 U.S. 726, 735 (1998) (administrative claim is not ripe where the "possibility that further consideration will actually occur before [implementation] is not theoretical, but real."). Because the entire rule will be vacated, the Commission can on remand, if it so chooses, modify and finalize any aggregation rules as part of any new regime it may promulgate.

4. Interpretation of Section 6a as a Whole

The Court is mindful that, in searching for the plain meaning of Section 6a, the Court must not take words in isolation, must view them in context, and must attempt to give effect to all words in the statute. Doing so does not, however, elucidate any of the ambiguities of the statute.

There is no question, as the CFTC argues, that Congress used traditionally mandatory language throughout the Dodd-Frank amendments to Section 6a. The CFTC relies on that language as support for its view that Congress stripped the CFTC of any discretion not to impose position limits even if the agency did not find it "necessary" or "appropriate" to do so. (Dkt. No. 25 at 23-24). For example, the CFTC relies on language stating that the Commission "shall" establish limits (subsection 6a(a)(2)(A)); that Congress imposed 180-day and 270-day deadlines on the limits "required" under subparagraph 6a(a)(2)(A) (subsection 6a(a)(2)(B)); and that Congress referred to the limits "required" under subparagraph (A) in other sections (6a(a)(2)(C);

6a(a)(2)(3)). The CFTC also points to the statute requiring the Commission to conduct a study of the "effects (if any) of the position limits imposed" and submit a report to Congress within 12 months. (Dkt. No. 38 at 22-23 (citing 15 U.S.C. § 8307)). Although the CFTC is correct that these provisions taken in isolation seemingly create a mandatory regime, the agency and this Court is required to attempt to give effect to all parts of the statute, including the ambiguous language. See SUTHERLAND at § 28:12 (stating that "when two provisions of code conflict, if reconciliation is possible, effect should be given to both sections").

Upon a review of the entire Section 6a as amended by Dodd-Frank, the Court finds that there are at least two plausible readings of the statute. First is the CFTC's interpretation: that the CFTC was mandated to set position limits, that it was stripped of any discretion not to set limits, that it was not required to find (either implicitly or explicitly) that the imposition of position limits both generally and with respect to certain commodities was necessary, that it was not required to determine whether the actual imposition of limits was appropriate both generally and with respect to certain commodities, and that it was required to impose those limits expeditiously.[6]

This interpretation, however, renders other parts of Section 6a mere surplusage. Significantly, it fails to give any meaningful effect to the very first clause of Section 6a(a)(2), which requires that the CFTC establish position limits "[i]n accordance with the standards set forth" in subsection (a)(1). As one court has held, although the inference the agency "'draw[s] as to the statute's meaning is not by any means unreasonable, it is also not inevitable and thus not

[6] So rigid is the Commission's view of the Dodd-Frank "mandate" that, at oral argument, agency counsel represented to the Court that the agency intended to eventually set position limits on derivatives tied to every non-exempt physical commodity. 2/27/12 Tr. at 31.

mandatory." See Humane Soc'y, 579 F. Supp. 2d at 19 (citing Air Transp. Ass'n of America v. FAA, 169 F.3d 1, 4 (D.C. Cir. 1999)).

The other plausible interpretation of Section 6a is the one that Plaintiffs offer. As Plaintiffs argue, "[t]he only reasonable reading of the Dodd-Frank amendments to Section 6a is that Congress intended the Commission to immediately gather evidence relating to whether excessive speculation was harming commodity markets and to impose position limits where necessary and appropriate to prevent an undue burden on the economy." (Dkt. No. 26 at 9). In other words, Plaintiffs do not seem to contest that the CFTC may be required to impose position limits, but that that obligation does not arise until the Commission first makes a finding that such position limits are necessary to combat the burden described in 6a(a)(1).

This Circuit has instructed that when "'construing a statute we are obliged to give effect, if possible, to every word Congress used.'" Murphy Exploration & Prod. Co. v. U.S. Dep't of Interior, 252 F.3d 473, 481 (D.C. Cir. 2001) (quoting Reiter v. Sonotone Corp., 442 U.S. 330, 339 (1979)). Moreover, it is well-settled that a statute is considered ambiguous when it is capable of being understood by reasonably well-informed persons in two or more different senses. See Nofziger, 878 F.2d at 446–47 (statute is ambiguous if it can be read in more than one way); see also SUTHERLAND at §§ 46:4, 45:2. Simply because a statute "is susceptible of one construction does not render its meaning plain if it is also susceptible of another, plausible construction . . . ." PDK Labs. Inc. v. U.S. DEA, 362 F.3d 786, 796 (D.C. Cir. 2004); see also Nat'l Rifle Ass'n of America, Inc. v. Reno, 216 F.3d 122, 131 (D.C. Cir. 2000) ("Though we owe no deference to the Attorney General's interpretation of statutory language at this stage of Chevron analysis, the plausibility of her view highlights the statute's ambiguity.") (citing Nofziger, 878 F.2d at 446–47) (emphasis added).

In sum, the Dodd-Frank amendments do not constitute a clear and unambiguous mandate to set position limits, as the Commission argues. Nor are those amendments clear and unambiguous in Plaintiffs' favor. The Court cannot uphold the CFTC's interpretation of the amendments under Chevron Step One. Nor, as set forth below, is this Court able to review the agency's interpretation under Chevron Step Two.

b. Chevron Step Two

Under Chevron step two, if a statute is silent or ambiguous on a particular issue, the Court must defer to the agency's interpretation of the statute if it is reasonable and consistent with the statutory purpose. See Pub. Citizen, 901 F.2d at 154 (citing Chevron, 467 U.S. at 844–45). The law of this Circuit is clear, however, that "Chevron step 2 deference is reserved for those instances when an agency recognizes that the Congress's intent is not plain from the statute's face." Peter Pan, 471 F.3d at 1354; see also Arizona, 281 F.3d at 254 (stating that "[d]eference to an agency's statutory interpretation is only appropriate when the agency has exercised its own judgment, not when it believes that interpretation is compelled by Congress.") (internal quotation marks omitted).

It is well-settled in this Circuit that "deference to an agency's interpretation of a statute is not appropriate when the agency wrongly believes that interpretation is compelled by Congress." Peter Pan, 471 F.3d at 1352, 1354 (internal quotation marks and citations omitted) (vacating and remanding agency decision because agency "premised its construction on the plain language of the statute, which it treated as unambiguous, and because we find that the statutory language is in fact ambiguous . . . ."); see also Sec'y of Labor, Mine Safety & Health Admin. v. Nat'l Cement Co. of California, Inc., 494 F.3d 1066, 1075 (D.C. Cir. 2007) ("Because the Secretary did not recognize the ambiguities inherent in the statutory terms, we do not defer to her plain meaning interpretation but instead remand for her to treat the statutory language as ambiguous.").

The CFTC correctly concedes that it is not entitled to Chevron deference with regard to its interpretation of Sections 6a(a)(2)-(7). (Dkt. No. 55 at 6, n.4). It is undisputed that the CFTC viewed the statute as clear and unambiguous, and that it viewed the Dodd-Frank amendments as compelling a particular result: that the agency was required to set position limits regardless of whether the agency thought it necessary and appropriate. That view was expressed throughout the rulemaking. See 76 Fed. Reg. at 71,626 ("[T]he CEA mandates that the Commission establish position limits for futures and options contracts traded on a designated contract market . . . ."); id. at 71,627 ("The Commission is required to establish position limits as Congress intentionally used the word, 'shall,' to impose the mandatory obligation."); id. at 71,628 ("The Commission disagrees that it must first determine that position limits are necessary before imposing them or that it may set limits only after it has conducted a complete study of the swaps market. Congress did not give the Commission a choice. Congress directed the Commission to impose position limits and to do so expeditiously"); id. at 71,627 ("[T]he Commission construes the amended CEA to mandate the Commission to impose position limits at the level it determines to be appropriate to diminish, eliminate, or prevent excessive speculation and market manipulation."); id. at 71,629, n.30 (stating that "Congress did not disturb the language under which the Commission previously acted to impose position limits, and added new language that makes clear that the types of limits described in sections 4a(a)(2), (a)(5), and (a)(6) are required"). Even Commissioner Dunn, who expressed his grave concerns about setting position limits in general, provided the third vote in favor of the rule because he believed that "Congress has tasked the CFTC with preventing excessive speculation by imposing position limits. This is the law. The law is clear, and I will follow the law." 10/18/11 Tr. at 11.

The Commission continued to take this position during this litigation. See Dkt. No. 38 at 23 ("There is only one plausible reading of the Dodd-Frank amendments: Congress unconditionally required the Commission to impose limits and to do so expeditiously"); id. ("[N]o other confirmation of the mandate beyond the language and structure of the Dodd-Frank amendments is needed"); id. at 1 ("But Plaintiffs ignore that Congress mandated that the Commission promulgate the Rule.").

As discussed above, the Dodd-Frank amendments to Section 6a are ambiguous and lend themselves to more than one plausible interpretation. When a statute is ambiguous, "it is incumbent upon the agency not to rest simply on its parsing of the statutory language. It must bring its experience and expertise to bear in light of competing interests at stake" to resolve the ambiguities in the statute. PDK Labs., 362 F.3d at 794, 797-98 (holding that agency's interpretation of statute was not entitled to deference because agency erroneously believed the meaning of the statute was plain and failed to rely on its expertise to discern the meaning of the statute); see also Peter Pan, 471 F.3d at 1354; Arizona, 281 F.3d at 254. Where an agency has failed to do so, it "is not for the court 'to choose between competing meanings.'" PDK Labs., 362 F.3d at 797-98 (quoting Alarm Indus. Commc'ns Comm. v. FCC, 131 F.3d 1066, 1072 (D.C. Cir. 1997)) (holding that Court must remand to the agency to resolve the ambiguity in the statute). "[I]f we find that an agency's stated rationale for its decision is erroneous, we cannot sustain its action on some other basis the agency did not mention." PDK Labs., 362 F.3d at 798 (citing SEC v. Chenery Corp., 332 U.S. 194, 200 (1947)).

The law of this Circuit, therefore, requires in this circumstance that the Court remand the rule to the agency so that it can fill in the gaps and resolve the ambiguities.[7] See PDK Labs., 362 F.3d at 798; see also Alarm Indus., 131 F.3d at 1072 (holding that statute did not have a plain meaning, as the Commission believed it did, and vacating and remanding the case to the Commission to resolve the ambiguity); Humane Soc'y, 579 F. Supp. 2d at 13 (noting that "when an agency wrongly concludes that its interpretation is mandated by the statute, a court will not impose its own interpretation of the statute.").

The Court expresses no opinion on whether the construction of Section 6a the CFTC now advances is permissible under Chevron Step Two. Although the Court does not foreclose the possibility that the CFTC could, in the exercise of its discretion, determine that it should impose position limits without a finding of necessity and appropriateness, it is not plain and clear that the statute requires this result. See Arizona, 281 F.3d at 256 ("Although we do not foreclose the possibility that HHS could, in the exercise of its discretion, determine that the allocation of common costs to TANF is not reasonably calculated to accomplish TANF's purpose, the statute does not require HHS to reach that conclusion."). Because the statute is ambiguous and a remand to the agency is warranted, the Court need not address Plaintiffs' other claims that the rule and its specific features violated the APA.

c. View of Congressional Amici and Legislative History

The Court received two amicus curiae briefs from members of Congress that were involved in the development of the Dodd-Frank Act. (Dkt. Nos. 48 & 49). Both groups wrote

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7 As this Circuit has held, it "may be that here, as in other cases, the strict dichotomy between clarity and ambiguity is artificial, that what we have is a continuum, a probability of meaning. In precisely those kinds of cases, it is incumbent upon the agency not to rest simply on its parsing of the statutory language." PDK Labs., 362 F.3d at 797.

in support of the CFTC. In one brief, the House Democratic Members of the Conference Committee ("House Democratic Members") on H.R. 4173 assert that the CFTC has historically had the power to establish position limits prophylactically. (Dkt. No. 49 at 2). The House Members state that the "CFTC was not required or even expected to analyze and determine whether or not it considered position limits to be efficacious in addressing possible harm from speculative trading." (Id. at 3). To support this proposition, they cite to instances in the legislative history where Congress made statements referring to the amendments as a "mandate" or a "requirement." (Id. at 3-5).

Another amicus brief was filed by 19 current United States Senators, some (but not all) of whom were involved in the development of the Dodd-Frank Act. (Dkt. No. 48 at 1). The Senators similarly state that "Dodd-Frank was designed and intended" to make CFTC position limits mandatory. (Id. at 3). Engaging in their own exercise of statutory interpretation, the Senators make most of the same arguments the CFTC makes and point to much of the same "mandatory" language. The Senators also urge this Court to conclude that the clear language of the Dodd-Frank amendments lead to only one result: that "Congress' drafting choice [] points only to the conclusion that Congress believed position limits to be 'required.'" (Id. at 5). The Senators also argue that the legislative history shows that the language of the Dodd-Frank amendments to Section 6a evolved from permissive to mandatory and, as such, reflect that the CFTC has no discretion not to impose position limits. (Id. at 16-20); (see also id. at 24) ("At each step in the legislative process, Congress made the position limits requirement stronger."). The Senators also cite to statements made by members of the House indicating their view that the Dodd-Frank amendments mandated the imposition of position limits. (Id. at 21-23).

The Court appreciates the efforts of amici to assist in determining the meaning of the relevant provisions of the CEA. The Court has considered amici's interpretations of both the legislative history and statutory text. Given the fundamental ambiguities in the statute, however, the Court is not persuaded by their arguments. Ultimately, the "judiciary functions as the final authority on issues of statutory construction . . . ." Wells Fargo Bank, 310 F.3d at 205-06. The views of amici do not override the ambiguities of the actual language that appears in the statute, which the CFTC failed to interpret in the first instance. In any event, amici do not point to any conclusive reasons to dispel the fundamental concerns that this Court has about the ambiguities in the statute.[8]

IV. Vacatur and Remand

Plaintiffs request that this Court vacate the Position Limits Rule and remand this matter back to the agency. (Dkt. No. 31 at 18, n.12). The CFTC contends that, even were this Court to find in Plaintiffs' favor, the Court has discretion to—and should—remand the rule to the CFTC without vacatur. (Dkt. No. 38 at 15, n.9).

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[8] For example, no one cites to legislative history that sheds any light on what Congress meant when it directed that any position limits under Section 6a(a)(2) must be established "In accordance with the standards set forth in paragraph (1) of this subsection . . . ." § 6a(a)(2) (emphasis added). Apparently that language was added after the Introduced Bill but before the Engrossed Bill. Despite mentioning many differences between the Introduced Bill versus the Engrossed Bill, the Senators do not provide guidance on the inclusion of "in accordance with the standards" in the Engrossed Bill. (Dkt. 48 at 17-20). Nor does the CFTC offer any explanation. Accordingly, although amici ask this Court to hold that the language of the Act evolved from permissive to mandatory and that the Dodd-Frank amendments required the Commission to set position limits no matter what, the same evolution reflects that Congress tied any new position limits to the "standards" of the Commission's longstanding discretionary authority in Section 6a(a)(1). Thus, even were this Court to give great weight to the legislative history, the Court cannot conclude that Congress has "directly spoken" to the issue of whether the Commission was stripped of any discretion not to impose position limits.

The CFTC is correct that the Court has discretion to decide whether to vacate the rule on remand. See Advocates for Highway & Auto Safety v. Fed. Motor Carrier Safety Admin., 429 F.3d 1136, 1151 (D.C. Cir. 2005) ("While unsupported agency action normally warrants vacatur . . . this court is not without discretion.") (internal quotation marks and citations omitted). When deciding whether to vacate the Court considers two factors: "seriousness of the order's deficiencies" and "the disruptive consequences of an interim change that may itself be changed." Allied-Signal, Inc. v. U.S. Nuclear Regulatory Comm'n, 988 F.2d 146, 150-51 (D.C. Cir. 1993). In this case, both factors weigh in favor of vacating the rule on remand.

First, as set forth above, the CFTC's error in this case was that it fundamentally misunderstood and failed to recognize the ambiguities in the statute. In circumstances such as this, our Circuit has found it appropriate to vacate the agency action on remand. See, e.g., Peter Pan, 471 F.3d at 1354-55; Nat'l Cement, 494 F.3d at 1077; PDK Labs., 362 F.3d at 799. By failing to acknowledge the statutory ambiguities in Section 6a, the CFTC instead relied exclusively on a "plain meaning" reading of the statute. The agency failed to bring its expertise and experience to bear when interpreting the statute and offered no explanation for how its interpretation comported with the policy objectives of the Act. The Court cannot be sure that the agency will interpret the statute in the same way and arrive at the same conclusion after further review and cannot be sure whether a similar position limits rule will withstand challenge under the APA. See Humane Soc'y, 579 F. Supp. 2d at 21.

Second, it would be far more disruptive if the Position Limits Rule were allowed to go into effect while on remand. As Plaintiffs note, remand without vacatur is often warranted once a rule has gone into effect and, as such, there is no apparent way to restore the status quo. (Dkt. No. 31 at 18, n.12); Sugar Cane Growers Coop. of Florida v. Veneman, 289 F.3d 89, 97 (D.C.

Cir. 2002) (holding that remand without vacatur was warranted where the rule had already gone into effect and, as such "[t]he egg ha[d] been scrambled and there [was] no apparent way to restore the status quo ante."). In this case, the Position Limits Rule, which according to both parties is a significant and unprecedented change in the operation of the commodity derivatives market, has not yet gone into effect. Moreover, the CFTC itself is reviewing and possibly revising its aggregation policies. (Dkt. Nos. 61, 63). The Court finds that vacatur of the rule would merely maintain the status quo and cause far less disruption than vacating the regime after it has gone into effect.

CONCLUSION

For the foregoing reasons, the Position Limits Rule is vacated and remanded to the Commission for further proceedings consistent with this Opinion. Moreover, Plaintiffs' Motion for Summary Judgment is granted and Defendant's Motion for Summary Judgment is denied. An Order accompanies this Memorandum.

Digitally signed by Judge Robert L. Wilkins
DN: cn=Judge Robert L. Wilkins, o=U.S. District Court, ou=Chambers of Honorable Robert L. Wilkins, email=[illegible], c=US
Date: 2012.09.28 14:38:34 -04'00'

Date: September 28, 2012

ROBERT L. WILKINS
United States District Judge

APPENDIX A

Effective: July 21, 2010

7 U.S.C.A. § 6a

§ 6a. Excessive speculation

(a) Burden on interstate commerce; trading or position limits

(1) In general

Excessive speculation in any commodity under contracts of sale of such commodity for future delivery made on or subject to the rules of contract markets or derivatives transaction execution facilities, or ~~on electronic trading facilities~~ with ~~respect to~~ swaps that perform or affect a significant price discovery ~~contract~~function with respect to registered entities causing sudden or unreasonable fluctuations or unwarranted changes in the price of such commodity, is an undue and unnecessary burden on interstate commerce in such commodity. For the purpose of diminishing, eliminating, or preventing such burden, the Commission shall, from time to time, after due notice and opportunity for hearing, by rule, regulation, or order, proclaim and fix such limits on the amounts of trading which may be done or positions which may be held by any person, including any group or class of traders, under contracts of sale of such commodity for future delivery on or subject to the rules of any contract market or derivatives transaction execution facility, or swaps traded on ~~an electronic trading~~or subject to the rules of a designated contract market or a swap execution facility ~~with respect to a~~, or swaps not traded on or subject to the rules of a designated contract market or a swap execution facility that performs a significant price discovery ~~contract~~function with respect to a registered entity, as the Commission finds are necessary to diminish, eliminate, or prevent such burden. In determining whether any person has exceeded such limits, the positions held and trading done by any persons directly or indirectly controlled by such person shall be included with the positions held and trading done by such person; and further, such limits upon positions and trading shall apply to positions held by, and trading done by, two or more persons acting pursuant to an expressed or implied agreement or understanding, the same as if the positions were held by, or the trading were done by, a single person. Nothing in this section shall be construed to prohibit the Commission from fixing different trading or position limits for different commodities, markets, futures, or delivery months, or for different number of days remaining until the last day of trading in a contract, or different trading limits for buying and selling operations, or different limits for the purposes of paragraphs (1) and (2) of subsection (b) of this section, or from exempting transactions normally known to the trade as "spreads" or "straddles" or "arbitrage" or from fixing limits applying to such transactions or positions different from limits fixed for other transactions or positions. The word "arbitrage" in domestic markets shall be defined to mean the same as "spread" or "straddle". The Commission is authorized to define the term "international arbitrage".

(2) Establishment of limitations

(A) In general

In accordance with the standards set forth in paragraph (1) of this subsection and consistent with the good faith exception cited in subsection (b)(2), with respect to physical commodities other than excluded commodities as defined by the Commission, the Commission shall by rule, regulation, or order establish limits on the amount of positions, as appropriate, other than bona fide hedge positions, that may be held by any person with respect to contracts of sale for future delivery or with respect to options on the contracts or commodities traded on or subject to the rules of a designated contract market

(B) Timing

(i) Exempt commodities

For exempt commodities, the limits required under subparagraph (A) shall be established within 180 days after July 21, 2010.

(ii) Agricultural commodities

For agricultural commodities, the limits required under subparagraph (A) shall be established within 270 days after July 21, 2010.

(C) Goal

In establishing the limits required under subparagraph (A), the Commission shall strive to ensure that trading on foreign boards of trade in the same commodity will be subject to comparable limits and that any limits to be imposed by the Commission will not cause price discovery in the commodity to shift to trading on the foreign boards of trade.

(3) Specific limitations

In establishing the limits required in paragraph (2), the Commission, as appropriate, shall set limits--

(A) on the number of positions that may be held by any person for the spot month, each other month, and the aggregate number of positions that may be held by any person for all months; and

(B) to the maximum extent practicable, in its discretion--

(i) to diminish, eliminate, or prevent excessive speculation as described under this section;

(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.

(4) Significant price discovery function

In making a determination whether a swap performs or affects a significant price discovery function with respect to regulated markets, the Commission shall consider, as appropriate:

(A) Price linkage

The extent to which the swap uses or otherwise relies on a daily or final settlement price, or other major price parameter, of another contract traded on a regulated market based upon the same underlying commodity, to value a position, transfer or convert a position, financially settle a position, or close out a position.

(B) Arbitrage

The extent to which the price for the swap is sufficiently related to the price of another contract traded on a regulated market based upon the same underlying commodity so as to permit market participants to effectively arbitrage between the markets by simultaneously maintaining positions or executing trades in the swaps on a frequent and recurring basis.

(C) Material price reference

The extent to which, on a frequent and recurring basis, bids, offers, or transactions in a contract traded on a regulated market are directly based on, or are determined by referencing, the price generated by the swap.

(D) Material liquidity

The extent to which the volume of swaps being traded in the commodity is sufficient to have a material effect on another contract traded on a regulated market.

(E) Other material factors

Such other material factors as the Commission specifies by rule or regulation as relevant to determine whether a swap serves a significant price discovery function with respect to a regulated market.

(5) Economically equivalent contracts

(A) Notwithstanding any other provision of this section, the Commission shall establish limits on the amount of positions, including aggregate position limits, as appropriate, other than bona fide hedge positions, that may be held by any person with respect to swaps that are economically equivalent to contracts of sale for future delivery or to options on the contracts or commodities traded on or subject to the rules of a designated contract market subject to paragraph (2).

(B) in establishing limits pursuant to subparagraph (A), the Commission shall--

(i) develop the limits concurrently with limits established under paragraph (2), and the limits shall have similar requirements as under paragraph (3)(B); and

(ii) establish the limits simultaneously with limits established under paragraph (2).

(6) Aggregate position limits

The Commission shall, by rule or regulation, establish limits (including related hedge exemption provisions) on the aggregate number or amount of positions in contracts based upon the same underlying commodity (as defined by the Commission) that may be held by any person, including any group or class of traders, for each month across--

(A) contracts listed by designated contract markets;

(B) with respect to an agreement contract, or transaction that settles against any price (including the daily or final settlement price) of 1 or more contracts listed for trading on a registered entity, contracts traded on a foreign board of trade that provides members or other participants located in the United States with direct access to its electronic trading and order matching system; and

(C) swap contracts that perform or affect a significant price discovery function with respect to regulated entities.

(7) Exemptions

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.

(b) Prohibition on trading or positions in excess of limits fixed by Commission

The Commission shall, in such rule, regulation, or order, fix a reasonable time (not to exceed ten days) after the promulgation of the rule, regulation, or order; after which, and until such rule, regulation, or order is suspended, modified, or revoked, it shall be unlawful for any person--

(1) directly or indirectly to buy or sell, or agree to buy or sell, under contracts of sale of such commodity for future delivery on or subject to the rules of the contract market or markets, or ~~derivatives transaction~~swap execution facility or facilities ~~or electronic trading facility~~ with respect to a significant price discovery contract, to which the rule, regulation, or order applies, any amount of such commodity during any one business day in excess of any trading limit fixed for one business day by the Commission in such rule, regulation, or order for or with respect to such commodity; or

(2) directly or indirectly to hold or control a net long or a net short position in any commodity for future delivery on or subject to the rules of any contract market or ~~derivatives transaction~~swap execution facility ~~or electronic trading~~ facility with respect to a significant price discovery contract in excess of any position limit fixed by the Commission for or with respect to such commodity: *Provided*, That such position limit shall not apply to a position acquired in good faith prior to the effective date of such rule, regulation, or order.

(c) Applicability to bona fide hedging transactions or positions

(1) No rule, regulation, or order issued under subsection (a) of this section shall apply to transactions or positions which are shown to be bona fide hedging transactions or positions as such terms shall be defined by the Commission by rule, regulation, or order consistent with the purposes of this chapter. Such terms may be defined to permit producers, purchasers, sellers, middlemen, and users of a commodity or a product derived therefrom to hedge their legitimate anticipated business needs for that period of time into the future for which an appropriate futures contract is open and available on an exchange. To determine the adequacy of this chapter and the powers of the Commission acting thereunder to prevent unwarranted price pressures by large hedgers, the Commission shall monitor and analyze the trading activities of the largest hedgers, as determined by the Commission, operating in the cattle, hog, or pork belly markets and shall report its findings and recommendations to the Senate Committee on Agriculture, Nutrition, and Forestry and the House Committee on Agriculture in its annual reports for at least two years following January 11, 1983.

(2) For the purposes of implementation of subsection (a)(2) for contracts of sale for future delivery or options on the contracts or commodities, the Commission shall define what constitutes a bona fide hedging transaction or position as a transaction or position that--

(A)(i) represents a substitute for transactions made or to be made or positions taken or to be taken at a later time in a physical marketing channel;

(ii) is economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise; and

(iii) arises from the potential change in the value of--

(I) assets that a person owns, produces, manufactures, processes, or merchandises or anticipates owning, producing, manufacturing, processing, or merchandising;

(II) liabilities that a person owns or anticipates incurring; or

(III) services that a person provides, purchases, or anticipates providing or purchasing; or

(B) reduces risks attendant to a position resulting from a swap that--

(i) was executed opposite a counterparty for which the transaction would qualify as a bona fide hedging transaction pursuant to subparagraph (A); or

(ii) meets the requirements of subparagraph (A).

(d) Persons subject to regulation; applicability to transactions made by or on behalf of United States

This section shall apply to a person that is registered as a futures commission merchant, an introducing broker, or a floor broker under authority of this chapter only to the extent that transactions made by such person are made on behalf of or for the account or benefit of such person. This section shall not apply to transactions made by, or on behalf of, or at the direction of, the United States, or a duly authorized agency thereof.

(e) Rulemaking power and penalties for violation

Nothing in this section shall prohibit or impair the adoption by any contract market, derivatives transaction execution facility, or by any other board of trade licensed, designated, or registered by the Commission or by any electronic trading facility of any bylaw, rule, regulation, or resolution fixing limits on the amount of trading which may be done or positions which may be held by any person under contracts of sale of any commodity for future delivery traded on or subject to the rules of such contract market or derivatives transaction execution facility or on an electronic trading facility, or under options on such contracts or commodities traded on or subject to the rules of such contract market, derivatives transaction execution facility, or electronic trading facility or such board of trade: *Provided*, That if the Commission shall have fixed limits under this section for any contract or under section 6c of this title for any commodity option, then the limits fixed by the bylaws, rules, regulations, and resolutions adopted by such contract market, derivatives transaction execution facility, or electronic trading facility or such board of trade shall not be higher than the limits fixed by the Commission. It shall be a violation of this chapter for any person to violate any bylaw, rule, regulation, or resolution of any contract market, derivatives transaction execution facility, or other board of trade licensed, designated, or registered by the Commission or electronic trading facility with respect to a significant price discovery contract fixing limits on the amount of trading which may be done or positions which may be held by any person under contracts of sale of any commodity for future delivery or under options on such contracts or commodities, if such bylaw, rule, regulation, or resolution has been approved by the Commission or certified by a registered entity pursuant to section 7a-2(c)(1) of this title: *Provided*, That the provisions of section 13(a)(5) of this title shall apply only to those who knowingly violate such limits.

June 28, 2012

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

David A. Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: RIN 3038-AD82: Aggregation of Position Limits for Futures and Swaps

Dear Mr. Stawick:

Managed Funds Association[1] ("MFA") appreciates the opportunity to provide comments to the Commodity Futures Trading Commission (the "Commission" or "CFTC") on its notice of proposed rulemaking to modify the Commission's aggregation requirements under its position limits rules[2] (the "Aggregation Proposal").[3] MFA generally supports the disaggregation relief for "owned entities" (*i.e.*, an entity owned by another person) provided in the Aggregation Proposal. MFA believes, however, that the Aggregation Proposal should be clarified to permit disaggregation in instances of commonly owned entities that share certain employees who do not control trading decisions, even if such employees have knowledge of trading decisions. MFA also believes that Commission staff should be provided with the authority to permit disaggregation on a case-by-case basis where passive ownership in the owned entity exceeds the 50 percent ownership threshold established by the Aggregation Proposal. We provide a few comments and recommendations in this respect, which we believe are consistent with the Commission's objectives in the Aggregation Proposal.

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[1] The Managed Funds Association (MFA) represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry's contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, North and South America, and all other regions where MFA members are market participants.

[2] See 17 CFR Part 151.

[3] Aggregation, Position Limits for Futures and Swaps, Notice of Proposed Rulemaking, 77 Fed. Reg. 31767 (May 30, 2012).

I. The Aggregation Proposal

The Aggregation Proposal addresses the section of the Commission's position limit rules that determine which accounts and positions a person must aggregate for the purpose of determining compliance with the position limit levels.[4] The Aggregation Proposal proposes to:

- adopt the following bright-line tests for the aggregation of a person's accounts and positions with the accounts and positions of any entities that are owned by such person (*i.e.*, the "owned entity"):
  - ownership in the owned entity of under 10 percent would not require aggregation absent common control;
  - ownership in the owned entity of over 50 percent would require aggregation; and
  - ownership in the owned entity from 10 percent up to and including 50 percent would not require aggregation if the person (*i.e.*, the owner of the owned entity) files with the Commission a certification demonstrating that it and the owned entity: (1) do not have knowledge of the trading decisions of the other; (2) trade pursuant to separately developed and independent trading systems; (3) have in place policies and procedures to preclude sharing knowledge of, gaining access to, or receiving data about, trades of the other; (4) do not share employees that control the trading decisions of the other; and (5) maintain a risk management system that does not allow the sharing of trade information or trading strategies between entities;
- allow "higher-tier entities" that have an ownership interest in a person filing a certification for disaggregation relief with the Commission to rely on such certification, provided that the higher-tier entity complies with the applicable conditions of disaggregation relief;
- expand and clarify the exemption from aggregation for those entities for whom sharing information to comply with position limits would violate certain laws;
- expand the exemption for the underwriting of securities to include ownership interests acquired through the market-making activities of an affiliated broker-dealer; and
- expand the definition of independent account controller under CFTC Rule 151.1 to include the managing member of a limited liability company.

[4] *See* 17 CFR 151.7.

II. Comments to Disaggregation Relief for Owned Entities

A. MFA Supports the Disaggregation Relief for Owned Entities

MFA believes that the disaggregation relief in the Aggregation Proposal strikes an appropriate balance between ensuring that a person does not create a large speculative position through ownership interests in multiple accounts, and permitting the legitimate trading activity of commonly owned and independently operated entities. MFA supports the amendments in the Aggregation Proposal that provide disaggregation relief to owned entities. MFA agrees with the Commission that ownership interests of less than 10 percent do not warrant aggregation and should not be subject to a notice filing. Likewise, MFA does not object to the proposed requirement of a notice filing to permit disaggregation when passive ownership is between 10 percent and 50 percent. As discussed below, however, MFA believes that ownership of greater than 50 percent should not presumptively constitute control in all circumstances, and that there should be a process for Commission staff to have the ability to grant disaggregation relief when passive ownership is greater than 50 percent, subject to demonstration by the commonly owned entities of the absence of de facto common trading control.

MFA supports the Commission's application of the proposed owned entity exemption to both financial and non-financial entities that have passive ownership interests. MFA believes that asset managers and corporate enterprises should be free to allocate capital efficiently across all types of business lines (including speculative trading ventures and commercial enterprises - both financial and non-financial) and independent managers without fear that this independent trading will be subject to aggregated position limits, possibly affecting their ability to participate in a given market.[5]

The Aggregation Proposal would permit the parent company of an entity relying on the owned entity exemption to rely on the exemption as well, without having to separately make a notice filing. The parent company, however, would need to comply with the other conditions of the exemption. MFA supports this proposed filing relief for "higher-tier" entities, which would eliminate filing redundancies by entities within the corporate structure. MFA does not believe that the proposed filing relief would affect the Commission's ability to see how exemptions are applied in the market because it retains the right to require the higher-tier entity to provide information regarding their claim for exemption.[6]

B. MFA Recommendations

1. Sharing of Personnel and Departmental Functions.

Two proposed conditions for disaggregation relief are that the commonly owned entities do not have knowledge of the trading decisions of the other and do not share employees that

[5] See Letter from Richard H. Baker, President and CEO, Managed Funds Association, to David A. Stawick, Secretary, Commodity Futures Trading Commission (March 28, 2011) available at: http://www.managedfunds.org/wp-content/uploads/2011/06/3.28.11-MFA_Position_Limits_final.3.28.pdf

[6] Aggregation Proposal, Rule 151.7(j)(3).

control the trading decisions of either entity.[7] In the Aggregation Proposal, the Commission requests comment on whether the sharing of attorneys, accountants, risk managers, compliance and other mid- and back-office personnel compromises the independence of trading because it would provide each entity with knowledge of the other's trading decisions.[8]

MFA believes that "knowledge" by either the owner entity or the owned entity should be attributed only if the individuals *that control the trading decisions* of the entity have information about the positions of the other. The positions of the two entities should not be aggregated simply because there are non-trading personnel that may have access to information about the positions of both entities through the performance of their regular responsibilities, provided that such individuals have no control over the trading decisions of either entity, and the entities have policies and procedures reasonably designed to prevent the disclosure of this information to individuals that have control over trading decisions.

MFA believes that the list of individuals who can attribute "knowledge" to an entity should not include any individual in any department who does not control the trading decisions of the entity. This would include attorneys, accountants, compliance and other mid- and back-office personnel that may provide services to both entities. This also may include employees who are involved in risk management of both entities, but who do not control the trading decisions of the entities. On the other hand, if the risk management personnel have the authority to influence the trading decisions of an entity, those individuals should not be permitted to be shared between entities that wish to disaggregate their trading positions. MFA also believes that knowledge should not be attributed to an entity if a board director or member of an advisory committee or advisory board of the owned entity is an employee of the owner who is not involved in the day-to-day trading decisions of the owned entity and who does not have real time information regarding the positions or trades of the owned entity that would permit the director or advisory committee member to influence trading decisions of the owner or owned entity. Similarly, the mere sharing of research personnel between the owner and the owned entity should not constitute knowledge on behalf of either entity. Sharing research as to market fundamentals, or technical indicators, does not itself constitute a trading decision or the exercise of trading control.[9] Research is simply one input into trading decisions that may be considered, among many others, by the recipient of the research. There should be no aggregation when the research personnel does not have control of the trading decisions of either entity, is not making trading recommendations for one entity based on its knowledge of the positions of the other entity, and the trading programs of the related entities have been independently developed and are implemented independently. The sharing of non-trading personnel between commonly owned entities would allow for continued operating efficiency and administrative convenience, and does not create a substantial risk that the entities together will knowingly create a large speculative position through their common ownership interest.

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[7] Aggregation Proposal, Rule 151.7(b)(1)(i)(A) and (D).

[8] Aggregation Proposal, at 31774.

[9] By analogy, the purchase of the same third-party research by the owner and the owned entity would not result in trading control by the third-party research provider.

2. CFTC Staff Approval of Disaggregation Relief for Ownership of Greater than 50 Percent.

While a bright-line test where passive ownership is greater than 50 percent provides certainty to market participants and the Commission, MFA does not agree that ownership of greater than 50 percent necessarily constitutes control in all circumstances. There may be instances where passive ownership is greater than 50 percent and disaggregation is warranted based on the particular facts and circumstances. If the Commission adopts a 50 percent bright-line test, MFA believes that the rules should permit a person to make a filing with the CFTC demonstrating compliance with the same criteria as required in the notice filing for disaggregation of 10 percent to 50 percent ownership (*i.e.*, no knowledge of trading decisions, separate and independent trading systems, procedures to prevent sharing of trading information, no shared employees that control trading decisions and a risk management system that does not allow sharing of trade information), but the filing would not become effective until it is reviewed and approved by Commission staff (rather than upon filing). MFA believes this strikes the appropriate balance between the rationale for the bright-line test in the Aggregation Proposal and Commissioner Sommer's concerns about the level at which this bright line is set.[10] This approach takes into account the varying needs of a very diverse group of market participants, while establishing a more flexible disaggregation approach that the Commission can effectively administer.

In an instance where passive ownership is greater than 50 percent, MFA acknowledges that there is a greater possibility for control of the entity that could require a careful analysis of the facts and circumstances before disaggregation is approved. MFA believes this is important to ensure that positions are not needlessly aggregated, perhaps at the expense of the entities' legitimate trading strategy. For example, if Holdco is a holding company that has a passive 51 percent investment in the publicly traded securities of each of Entity X, Entity Y and Entity Z, each of which are independently operated companies, Holdco should not be precluded from having the opportunity to demonstrate to CFTC staff its compliance with the requirements of passive ownership and not be required to aggregate the positions. In these instances, MFA believes that it would be appropriate for Commission staff to have the authority to review and approve an application for disaggregation relief where ownership in the owned entity exceeds 50 percent.

3. Clarification of Application of CFTC Rule 151.7.

MFA suggests that the Commission clarify a potential ambiguity in its rules regarding the application of the aggregation and exemptions from aggregation standards for federal position limits to the position limits established by a designated contract market ("DCM") or swap execution facility ("SEF"). While CFTC Rule 151.11(e) specifies that DCM/SEF position limits are subject to the aggregation standards of CFTC Rule 151.7, the aggregation standards in CFTC

[10] *See* Statement of Commissioner Jill E. Sommers, Aggregation Proposal, at 31783, ("I question whether a bright-line approach is the correct approach, and if it is, whether the line should be drawn at 50%. In the absence of knowledge of, and control over, trading of an owned entity, is there a real difference between owning 49 percent and owning 50%? I don't think there is.")

Rule 151.7 refer only to the aggregation and exemptions from aggregation for the federal position limits, without specifically providing for a parallel exemption from aggregation from DCM/SEF limits. For the sake of clarity and to provide consistent treatment of position limits established by the CFTC and trading facilities, MFA believes that aggregation standards in CFTC Rule 151.7 also should refer to the aggregation and exemptions from aggregation for the DCM/SEF position limits.

* * * * *

We appreciate the opportunity to offer suggestions to the Aggregation Proposal. We would be happy to discuss our comments or any other issues raised in the Aggregation Proposal at greater length with the Commission or its staff. If the staff has any questions, please do not hesitate to call Jennifer Han or the undersigned at (202) 730-2600.

Respectfully submitted,

/s/ Stuart J. Kaswell

Stuart J. Kaswell
Executive Vice President & Managing Director,
General Counsel

Cc: The Hon. Gary Gensler, Chairman
The Hon. Bart Chilton, Commissioner
The Hon. Jill E. Sommers, Commissioner
The Hon. Scott D. O'Malia, Commissioner
The Hon. Mark P. Wetjen, Commissioner

Alternative Investment Management Association

David A. Stawick,
Secretary of the Commission,
Commodity Futures Trading Commission,
Three Lafayette Centre,
1155 21st Street, NW.,
Washington, DC 20581

Submitted via email: secretary@cftc.gov

6 July 2012

Dear Mr Stawick,

CFTC Notice of Proposed Rulemaking - Aggregation Under Part 151, Position Limits for Futures and Swaps

The Alternative Investment Management Association (AIMA)[1] appreciates the opportunity to provide comment on the Commodity Futures Trading Commission (CFTC) Notice of Proposed Rulemaking on aggregation under Part 151, Position Limits for Futures and Swaps (the Notice). The Notice proposes clarification and amendment of the CFTC Final Rule and Interim Final Rule of 18 November 2011, which established a position limits regime for 28 exempt and agricultural commodity futures and options contracts and the physical commodity swaps which are economically equivalent to such contracts.

1. Introduction

AIMA's members are active participants in the US commodity markets and play a key role in providing liquidity to aid price discovery by acting as willing buyers for producers and willing sellers for end users. As set out in our previous responses to the CFTC, we continue to believe that the participation of financial institutions in the commodity markets, including the derivatives market, is of genuine utility and that little evidence exists of a direct causal relationship between market volatility, higher prices and the participation of financial institutions within the market.

AIMA believes that the Notice is a positive development in relation to the CFTC position limits regime and welcomes the CFTC's willingness to take the reasoned opinions of industry stakeholders into account. In particular, we welcome the CFTC's clarification of how the violation of laws exemption would be applied to circumstances involving a 'reasonable risk' of breach and the proposed extension of the latter exemption to include the provisions of US states and foreign jurisdictions.

We are keen to assist the CFTC's work in ensuring that its position limit rules are effective and proportionate in achieving their objectives. We, therefore, set out below a number of constructive comments on the proposed rules contained within the Notice, in particular regarding the owned entity exemption, along with suggestions for amendment and further guidance.

2. AIMA's Detailed Comments

a) *Owned Entity Exemption*

AIMA largely agrees that aggregation should be on the basis of control. This is especially so in the context of investment funds, where an individual managed capital investor may technically own, directly or indirectly, a greater than 10% stake in an entity, yet be entirely passive regarding the commercial decision-making of that entity. The requirement for investors to aggregate positions held by such accounts with their own is disproportionately burdensome on managed capital investors and should be amended.

[1] AIMA is the trade body for the hedge fund industry globally; our membership represents all constituencies within the sector – including hedge fund managers, fund of hedge funds managers, prime brokers, fund administrators, accountants and lawyers. Our membership comprises over 1,300 corporate bodies in 45 countries.

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AIMA, therefore, welcomes the possibility of an exemption from aggregation of the positions held by an entity in which a person holds greater than 10% equity or ownership interest with the latter person's own positions. However, we would highlight the following key areas which we believe merit further amendment, clarification and guidance:

i) Greater than 50% Equity or Ownership Threshold

AIMA appreciates the CFTC's concerns that it may be inconsistent with the statutory requirement to aggregate on the basis of ownership positions held by an entity in which a person has a greater than 50% ownership or equity interest are excluded from the aggregation requirement.

However, for the purpose of CFTC concerns regarding direct or indirect influence on, or coordination of, positions as a result of high levels of ownership, AIMA considers that the greater than 50% threshold is unnecessary.

The combined effect of the other criteria contained within the Owned Entity Exemption would render the 50% ownership threshold less relevant. Taken together (a) enforcement of the mutual prohibition of knowledge of the others' trading decisions; (b) the requirement for the adoption of procedural barriers to the sharing of knowledge of and access to each others' trades; (c) the prohibition on sharing employees who control trading decisions; and (d) the requirement for trading to be pursuant to independent trading systems would mean that entities could not coordinate or exert influence upon decisions as they would have no knowledge of, and be procedurally separate from, the decision making process. Nonetheless, if the CFTC wishes to maintain the greater than 50% ownership threshold, AIMA believes that there should be the possibility of a case-by-case application for relief.

ii) Shared Employees with Control

Proposed Rule 151.7(b)(1)(i)(D) prevents the sharing of employees which control the trading decisions owned entities. However, when combined with Proposed Rule 151.7(b)(1)(i)(A), this requirement is seemingly extended to prohibit the sharing of any employees which may be able to attribute knowledge of the trading decisions of the opposing entity. AIMA strongly believes that any sharing of employees who are held to attribute 'knowledge' to an entity for the purpose of Proposed Rule 157(b)(1)(i)(A) should not include any individual who does not have control of the trading decisions of his/her respective entity. In response to the CFTC's direct query regarding the suitability of sharing 'attorneys, accountants, risk managers, compliance and other mid- and back-office personnel' which do not have the authority to influence trading decisions, we do not believe that such sharing would involve any loss or compromise of independence.

iii) Application of the Exemption Criteria to both Investor and Owned Entity

As currently drafted, Proposed rules 151.7(b)(1)(i)(A)&(C) within the Notice would appear to prohibit either party from having knowledge of the other's trading decisions and to require both parties to have enforced written procedures to preclude any such knowledge of, access to and reception of trade data regarding the trades of the other. AIMA questions the necessity of applying the aforementioned requirements to the relevant owned entity in which the person has invested.

As confirmed within the Notice, aggregation under the CFTC regime is justified on the basis of both ownership and control. Individuals who own less than 10% of an entity are considered not to have control, whereas if an individual owns an equal to or greater than 10% equity stake in an entity, that individual is subject to a rebuttable presumption that he does exercise control. In both situations, the owned entity itself has no such ownership or control interest in its investor, and therefore, should not be required to adopt any procedures or incur undue costs associated with the regime. Whether the owned entity has knowledge of its investors' trading decisions is entirely irrelevant for the purposive intention of the strict conditions under Proposed rule 151.7(b)(1)(i), namely to prevent circumvention of the position aggregation regime by individuals in control of an owned entity.

In addition, a requirement for an individual to confirm to the CFTC that an owned entity in fact complies with the criteria is not practically viable.

AIMA would suggest that, in order to ensure the proportionality of the regime, the conditions for the Owned Entity Exemption be applied to the individual seeking application and not to the owned entity.

iv) Requirement for Separately Developed and Independent Trading Systems

AIMA agrees with the CFTC that, in order to prevent the circumvention of the aggregation rules and the exploitation of the Owned Entity Exemption, the conditions for its application must be rigorous. In this regard, we support the requirement within the Notice for the exemption applicant and owned entity to operate independent trading systems so that knowledge of trading decisions and other data is not shared between the two, thus leading to potential collaboration and direct or indirect influence.

However, we believe that the requirement under Proposed rule 151.7(b)(1)(i)(B) for trading to be pursuant to 'separately developed' trading systems would place a disproportionate burden upon market participants, which could be difficult to overcome.

Many trading systems operated by investment firms are developed by specialist third-party entities which license their products to numerous participants across the market; this is especially so for off-the-shelf execution algorithms used by many investment managers. Such specialist development, through comparative advantage, enables higher quality and more efficient systems to be created than would otherwise be possible, thus resulting in more consistent and efficient markets and greater profitability for all participants.

Economically, if participants do choose to comply with the separate development requirement, this would mean that specialist systems developers would suffer a large fall in demand; possibly leading to unnecessary business failures. Accordingly, this would require individual participants to develop their own systems, thereby losing all efficiency benefits of the comparative advantage currently enjoyed by specialist third party developers since each would lack the consolidated expertise or the economies of scale to undertake the extensive research and development of successful systems and algorithmic products.

From the viewpoint of optimising proportionality, the requirement for the use of separately developed systems would also result in the arbitrary withholding of the aggregation exemption due to the incidental fact that the individual applicant for the exemption had licensed the same system as the relevant owned entity. This would have the counterintuitive result of barring the possibility of an Owned Entity Exemption, even though the individual and owned entity's systems were, in practice, entirely separate and operated independently of each other.

The requirement, as currently formulated, is not a suitable means by which to achieve the objective of preventing surreptitious collaboration and goes far beyond that which is necessary by imposing undue costs upon participants and the markets as a whole.

AIMA, therefore, proposes that the owned entity exemption condition be amended so that, as long as the trading systems operate independently and no information may be leaked between them, it should not matter whether the systems were originally developed by a common party.

v) Requirement to Have and Enforce Written Procedures to Preclude Each Other from Having Knowledge of, Gaining Access to or Receiving Data about Trades of the Other

AIMA has concerns that the requirement and examples contained within Proposed rule 151.7(b)(1)(i)(C) are overly broad and too vague.

Certain of our members, in particular, have inquired as to what is meant by the terms 'document routing' and whether the notion of 'separate physical locations' is simply a requirement for firms to document the fact that all clients must be geographically separate. In addition, we would question whether the necessity for procedures to 'maintain the independence of their activities' is consistent with the principal requirement under Proposed rule 151.7(b)(1)(i)(C), which relates not to independence of activities, but to knowledge, access and trade data. AIMA's members would be especially grateful for further guidance to be provided by the CFTC on this procedural criterion, in a similar manner as has been undertaken, for example, for Proposed rule 151.7(b)(1)(i)(A).

AIMA would also be grateful for clarification of the how the criterion within Proposed rule 151.7(b)(1)(i)(C) would interact with that within Proposed rule 151.7(b)(1)(i)(A). For example, page 26 of the Notice asserts that the CFTC 'does not consider knowledge of overall end of day position information to necessarily constitute knowledge of trading decisions', therefore satisfying the criteria within Proposed rule 151.7(b)(1)(i)(A). AIMA is interested to discover whether this would mean that the provision of end of day position information (in compliance with the above Proposed rule on having knowledge of trading decisions) would still result in non-compliance with Proposed rule 151.7(b)(1)(i)(C) regarding the adoption of procedures to prevent knowledge of/access to/receipt of data on the trading of the other entity.

b) *Violation of Laws Exemption*

AIMA welcomes the CFTC's provisions for the exemption from aggregation of situations when the sharing of information between a person and an owned entity regarding position information would result in the violation of federal law. We are particularly grateful that the CFTC has clarified that the exemption applies in situations when the sharing of such information would result in a 'reasonable risk' of a breach of laws or regulations, and is extended to include both state rules and laws of a foreign jurisdiction.

Our members, however, have certain suggestions which they would like to be considered by the CFTC:

i) Extension to all laws, regulations, administrative rulings and court orders

The Notice currently provides exemptions in situations which risk a breach of the laws or regulations of the US federal government, US states and laws of a foreign jurisdiction. This is a positive step. However, to ensure the equal application of the exemption to all market participants, AIMA believes that it is important for it to be expanded to include all laws, regulations, administrative rulings and court orders from any governmental authority which has jurisdiction over the persons seeking to utilise it.

ii) Requirement to gain an opinion of Counsel

AIMA understands the petitioners' concerns regarding the requirement to obtain an opinion of Counsel - which has been confirmed by the CFTC within the Notice - and agrees that this requirement may impose an unreasonable and disproportionate burden on market participants seeking to utilise the exemption.

We would argue that legal opinions are typically issued by law firms and attorneys on specific matters such as enforceability or security interests and may not be suitable for the issue of violation of laws. In particular, law firms may not be willing, or may not be able, to provide an opinion. This lack of certainty may disincentivise participants from applying in good faith for a prospective exemption in the first place.

AIMA would propose that the requirement of an opinion of counsel be replaced by a 'supporting legal documentation' requirement. Such 'supporting legal documentation' could include:

- a legal opinion prepared by internal or external counsel;
- a legal memorandum prepared by internal or external counsel;
- a copy of a court order;
- a copy of an administrative ruling; or
- any other document(s) which the CFTC considers would enable it to review the facts and circumstances in support of the claimed exemption.

Maximising the flexibility of the regime in this way would place a more proportionate burden on applicants, whilst still achieving the CFTC's legislative aim of providing reliable official documentation by which to evaluate of applications for exemption.

c) *Exemption for Independent Account Controllers (IACs)*

As the CFTC will be aware, investment funds may be structured in numerous different ways, including Limited Liability Companies and Limited Partnerships. AIMA, therefore, welcomes the addition of the manager or managing member of a limited liability company to the definition of an IAC. We would however, like to stress that the rules contained within the Notice do not take the impact of the extraterritorial application of the CFTC's rules into account.

A great number of foreign investment funds and entities could potentially be treated as commodity pools, CTAs or CPOs - despite not being organised as such - and it is vital for such commodity pools which are not structured as limited liability companies or partnerships to be able to make use of the IAC exemption. For this reason, AIMA proposes that the CFTC's rules on the exemption of IACs from the aggregation regime should ensure that any entity or person is included in the definition of an IAC where that entity or person has a role in respect to an entity which is substantially equivalent to the role of a general partner within a limited liability partnership or manager/managing member within a limited liability company.

3. Conclusion

Overall, AIMA supports the policy objectives of the proposed rules contained within the Notice. However, it is vital for industry participants that proportionality is ensured and legal certainty maximised so that they are able to continue providing benefits, such as liquidity, to the commodities market and may confidently budget for, develop and adopt systems and procedures accordingly to ensure their efficient compliance.

We thank you for this opportunity to comment on the Commission's proposed rules and are, of course, happy to discuss any of our comments with you in greater detail if this would assist.

Yours sincerely,

Jiří Król
Director of Government & Regulatory Affairs

February 7, 2014

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

Melissa D. Jurgens
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: RIN 3038-AD82 Aggregation of Positions

Dear Ms. Jurgens:

Managed Funds Association[1] ("**MFA**") appreciates the opportunity to provide comments to the Commodity Futures Trading Commission (the "**Commission**" or "**CFTC**") on its notice of proposed rulemaking to modify the Commission's aggregation requirements under its position limits rules[2] (the "**2013 Aggregation Proposal**").[3] MFA members are particularly interested in the impact the 2013 Aggregation Proposal will have on them, in particular because MFA members may implement multiple independent trading strategies, may be invested in "owned entities" (including operating companies that are not commodity pools), and may be passive owners in the fund of funds context.

MFA members are among the most sophisticated institutional investors and play an important role in our financial system. They are active participants in the commodity interest and securities markets, including over-the-counter ("**OTC**") derivatives markets. Our members provide liquidity and price discovery to capital markets, capital to companies seeking to grow or improve their businesses, and important investment options to investors seeking to increase portfolio returns with less risk, such as pension funds trying to meet their future obligations to

[1] Managed Funds Association (MFA) represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry's contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, the Americas, Australia and many other regions where MFA members are market participants.

[2] *See* 17 C.F.R. Part 151; *and* Position Limits for Derivatives, 78 Fed. Reg. 75,680 (proposed Dec. 12, 2013) (proposing amendments to the position limits regime primarily under 17 C.F.R. Part 150).

[3] Aggregation of Positions, 78 Fed. Reg. 68,946 (proposed Nov. 15, 2013).

plan beneficiaries. MFA members engage in a variety of investment strategies across many different asset classes. The growth and diversification of investment funds have strengthened U.S. capital markets and provided investors with the means to diversify their investments, thereby reducing overall portfolio investment risk. As investors, MFA members help dampen market volatility by providing liquidity and pricing efficiency across many markets. Each of these functions is critical to the orderly operation of our capital markets and our financial system as a whole.

MFA member firms implement diverse investment strategies. Member firms may execute multiple, independent trading strategies that are implemented by different and separate business units or employees. Many MFA member firms, as part of their investment strategy, invest in one or more, and sometimes multiple, small-, mid-sized and/or large operating companies. In addition, some MFA member firms use a "fund of funds" structure to make investments, whereby a master fund holds a passive interest and invests in other, separately-managed funds. Without disaggregation relief, such business units and master funds would be required to aggregate all of their positions with those of the separately-managed business units, operating companies or funds. Accordingly, such relief is critical to our members' ability to pursue varying investment strategies to achieve the investment goals of those investing in hedge funds.

MFA generally supports the disaggregation relief for owned entities provided in the 2013 Aggregation Proposal. MFA appreciates the Commission's modification of its position on the sharing of personnel and departmental functions among commonly-owned entities and the Commission's proposed parallel disaggregation relief under the position limit rules of designated contract markets and swap execution facilities.[4] MFA supports the Commission's modified approach toward entities where passive ownership in the owned entity exceeds the 50 percent ownership threshold. However, MFA is concerned that the Commission's conditions for obtaining this relief are too restrictive and will undercut the ability of many entities to avail themselves of such relief. MFA also believes that the Commission should modify the 2013 Aggregation Proposal in certain respects relating to: (1) the conditions for disaggregation relief for greater than 50 percent owned entities and; (2) the condition of disaggregation relief for limited partners, shareholders or other pool participants that prohibits such persons from having a direct or indirect 25 percent or greater ownership or equity interest in a commodity pool where the operator of the pool is exempt from registration under CFTC Rule 4.13. In addition, MFA recommends that the Commission increase the level at which aggregation is required from 10 percent to 25 percent for an entity's passive ownership interest in an operating company. Also, MFA proposes that when aggregation is required based on common ownership and no exemption is available, the Commission should adopt a *pro rata* aggregation scheme so that aggregation would be based on proportionate ownership, rather than automatically attributing 100 percent of

[4] The Commission proposes to require designated contract markets and swap execution facilities to "have uniform aggregation policies that mirror the federal aggregation provisions for all types of commodity derivative contracts, including for contracts that are not subject to federal position limits." Position Limits for Derivatives, 78 Fed. Reg. at 75,756. Proposed rules 150.5(a)(5) and 150.5(b)(8) stipulate that exchanges must maintain aggregation rules that conform to CFTC Rule 150.4. Position Limits for Derivatives, 78 Fed. Reg. at 75,829-30.

the owned entities' positions to the owner. We provide a few comments and recommendations in these respects, which we believe are consistent with the Commission's objectives of the 2013 Aggregation Proposal.

I. EXECUTIVE SUMMARY

MFA has carefully considered the 2013 Aggregation Proposal and is providing its comments and recommendations, which are summarized as follows:

- We support the Commission's clarification that shared research personnel and research amongst the commonly-owned entities would not violate the condition that the commonly-owned entities do not share employees that control the owned entity's trading decisions. MFA requests that the Commission further clarify that the requirement that research personnel "do not influence (e.g., 'have a say in') or direct the entities' trading decisions" is properly interpreted to mean that research personnel are not precluded from providing market research, including, for example, market fundamentals or technical indicators, support or resistance levels, and trade recommendations, so long as such personnel do not direct or control trading decisions of the owned-entities.
- We believe that aggregation should not be required when an entity has a ten percent or greater passive ownership or equity interest in an operating company. Instead, aggregation of positions under these circumstances should not be required unless the passive ownership interest in such operating company is 25 percent or greater.
- We support providing disaggregation relief for greater than 50 percent owned entities, but the Commission's application process for such entities seeking exemptive relief appears to be highly discretionary and introduces unnecessary uncertainty with its open-ended review period. We recommend that the Commission adopt a notice filing procedure applicable to such relief and more transparent standards for relief.
- We believe that the proposed conditions for exemptive relief from aggregation for persons with a greater than 50 percent ownership interest in an owned entity are unduly restrictive. The Commission has not justified the requirement that all positions be *bona fide* hedging transactions or, if the positions of the owned-entity do not so qualify, the owned-entity's positions must not exceed 20 percent of the applicable speculative position limit.
- We do not believe that consolidated financial statements are a useful way to determine whether common trading control exists amongst commonly-owned entities. Accordingly, we believe that the Commission should eliminate this condition from the requirements for disaggregation relief for persons with a greater than 50 percent ownership interest in an owned entity.
- We support the Commission's proposal to exercise its authority under section 4a(a)(7) of the Commodity Exchange Act (the "**Act**") to provide exemptive relief from aggregation in the event that a greater than 50 percent owned entity does not qualify for the exemptive relief provided in proposed rule 150.4(b)(3). However, the Commission should provide

clear guidance describing the manner it will review requests for exemptive relief made pursuant to section 4a(a)(7) of the Act.

- We believe that the Commission should remove the passive ownership limitation of 25 percent in a commodity pool that applies to a manager that is exempt from registration as a commodity pool operator under CFTC Rule 4.13 in light of the rescission of CFTC Rule 4.13(a)(4). Failure to do so will have the practical effect of creating a trap for passive investors in CFTC Rule 4.13 exempt commodity pools who do not control investment decisions or have the ability to monitor or access information relating to investments in such investee funds.
- MFA believes that general partners, in addition to limited partners, should be eligible for disaggregation relief so long as they do not possess control over the trading decisions of the partnership.
- We believe that, when aggregation is triggered due to common ownership and no exemption is available, it is appropriate to aggregate only an entity's *pro rata* share of the position in an amount proportionate to its ownership interest.

II. THE 2013 AGGREGATION PROPOSAL

The 2013 Aggregation Proposal addresses the portion of the Commission's position limit rules that determine which accounts and positions a person must aggregate for the purpose of determining compliance with the speculative position limit levels.[5] The 2013 Aggregation Proposal would:

A. Require aggregation for persons using substantially identical trading strategies.[6]

B. Adopt the following bright-line tests for the aggregation of a person's accounts and positions with the accounts and positions of any entities that are owned by such person (*i.e.*, the "owned entity"):

1. ownership in the owned entity of under 10 percent would not require aggregation absent common control;[7]

2. ownership in the owned entity from 10 percent up to and including 50 percent would not require aggregation if the person (*i.e.*, the owner of the owned entity) files with the Commission a certification, which would be effective upon filing,[8] demonstrating that it and the owned entity: (1) do not have knowledge of the trading decisions of the other; (2) trade

[5] *See* 17 C.F.R. 151.7; *and* proposed rule 150.4, Aggregation of Positions, 78 Fed. Reg. at 68,976.

[6] Proposed rule 150.4(a)(2), Aggregation of Positions, 78 Fed. Reg. at 68,976.

[7] *Id.*, proposed rule 150.4(a)(1).

[8] *Id.*, proposed rule 150.4(b)(2).

pursuant to separately developed and independent trading systems; (3) have in place and enforce policies and procedures to preclude sharing knowledge of, gaining access to, or receiving data about, trades of the other; (4) do not share employees that control the trading decisions of the other; and (5) maintain a risk management system that does not allow the sharing of trade information or trading strategies between entities; and

3. ownership in the owned entity of over 50 percent would require aggregation (subject to the potential relief described in C, below).

C. Add a new case-by-case exemption for entities owning greater than 50% of another entity (financial or non-financial) so long as certain requirements are satisfied, including: (1) that the owned entity is not required under U.S. generally accepted accounting principles to be, and is not, consolidated on the financial statement of such person; (2) that the owner satisfies the conditions specified for an entity owning 10 percent up to and including 50 percent of the owned entity (*see* B.2, above) and it has procedures in place that are reasonably effective to prevent coordinated trading decisions by such person; (3) that each member of the owned entity's board certifies that he/she does not control the trading decisions of the owned entity; and (4) a certification requirement that either all of the owned entity's positions qualify as *bona fide* hedging transactions or the owned entity's positions that do not so qualify do not exceed 20 percent of any position limit currently in effect. The owner must file a certification with the Commission, but such certification only would become effective when Commission staff, in its discretion, has given the owner affirmative confirmation that the owner satisfies all of the requirements. There is no requirement for staff to review the certification or grant confirmation of the requested relief within a specified time period.[9]

D. Retain certain exemptions with only minor changes, including the passive pool participant (encompassing certain limited partners, shareholders or other pool participants),[10] FCM[11] and Independent Account Controller[12] exemptions. The definition of Independent Account Controller has been expanded to include the managing member of a limited liability company and managers of employee benefit plans under CFTC Rule 4.5. However, the Independent Account Controller exemption would no longer be self-executing, and, under the proposed rule, would require a filing with the Commission. Similarly, passive pool participants and FCMs, to be eligible for disaggregation relief, would be required to file a notice with the Commission.

[9] *Id*. at 68,976-77, proposed rule 150.4(b)(3).

[10] *Id*. at 68,976, proposed rule 150.4(b)(1).

[11] *Id*. at 68,977, proposed rule 150.4(b)(4).

[12] *Id*., proposed rule 150.4(b)(5).

E. Provide relief from aggregation, similar to the previously-proposed rules,[13] pursuant to:

1. the Underwriter[14] and Broker-Dealer[15] exemptions (which would expand the exemption for the underwriting of securities to include ownership interests acquired through the market-making activities of an affiliated broker-dealers);

2. an exemption for "higher-tier entities"[16] that have an ownership interest in a person filing with the Commission a certification for disaggregation relief to rely on such certification, provided that the higher-tier entity complies with the applicable conditions of disaggregation relief; and

3. an exemption for those entities for whom sharing information to comply with position limits would violate certain laws.[17]

F. Establish a notice filing regime for reliance on the majority of these exemptions.[18] The aggregation exemption would be effective upon submission of the notice to the Commission.

III. COMMENTS TO DISAGGREGATION RELIEF FOR OWNED ENTITIES

A. MFA Supports the Disaggregation Relief for Owned Entities

Overall, MFA believes that the disaggregation relief in the 2013 Aggregation Proposal attempts to strike an appropriate balance between permitting the legitimate trading activity of commonly-owned and independently-operated entities and ensuring that a person does not create an unduly large speculative position through ownership or control of multiple accounts. MFA supports the rule amendments that provide disaggregation relief to owned financial and non-financial entities. MFA believes that asset managers and corporate enterprises should be free to allocate capital efficiently across all types of business lines (including speculative trading ventures and commercial enterprises – both financial and non-financial) and independent

[13] Aggregation, Position Limits for Futures and Swaps, 77 Fed. Reg. 31,767 (proposed May 30, 2012).

[14] Proposed rule 150.4(b)(6), Aggregation of Positions, 78 Fed. Reg. at 68,977.

[15] *Id.*, proposed rule 150.4(b)(7).

[16] *Id*. at 68,978, proposed rule 150.4(b)(9).

[17] *Id*. at 68,977-78, proposed rule 150.4(b)(8).

[18] *Id*. at 68,978, proposed rule 150.4(c). Notice filings would be required for exemptive relief made on behalf of: (1) a principal or affiliate of a commodity pool operator; (2) entities with an ownership interest in an owned entity between 10 percent and 50 percent, inclusive; (3) FCMs; (4) independent account controllers; and (5) a person where information sharing would violate a law or regulation.

managers without fear that this independent trading will be subject to aggregated position limits, possibly affecting their ability to participate in a given market.[19]

MFA supports the 2013 Aggregation Proposal's relief for "higher-tier" entities, which would permit the parent company of an entity relying on the owned entity exemption to rely on the exemption as well, without having to separately make a notice filing. The parent company, however, would need to comply with the other conditions of the exemption. MFA does not believe that the proposed filing relief would adversely affect the Commission's ability to see how exemptions are applied in the market because it retains the right to require the higher-tier entity to provide information regarding its claim for exemption.[20] MFA supports this proposed filing relief for "higher-tier" entities because it would eliminate filing redundancies by entities within the corporate structure without compromising the integrity of the speculative position limits regime.

MFA acknowledges and appreciates that the Commission incorporated many of MFA's recommendations[21] in its 2013 Aggregation Proposal. MFA is pleased that the Commission has stated that the sharing of attorneys, accountants, risk managers, compliance, other mid- and back-office personnel, board or advisory committee members, research personnel or other employees for training, operational or compliance purposes would not compromise independence and would not result in a violation of the criteria if such employees do not control, direct, influence or participate in the entities' trading decisions.[22] MFA believes that the 2013 Aggregation Proposal is consistent with the Commission's longstanding position on the sharing of employees, including research personnel, and the sharing of research. For example, in the Commission's 1979 Aggregation Policy Statement, the Commission stated that "research information concerning fundamental demand and supply factors and other data should be readily available to a person who directs trading in a customer account or programs."[23]

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[19] *See* Letter from Richard H. Baker, President and CEO, Managed Funds Association, to David A. Stawick, Secretary, Commodity Futures Trading Commission (Mar. 28, 2011), *available at* http://www.managedfunds.org/wp-content/uploads/2011/06/3.28.11-MFA_Position_Limits_final.3.28.pdf.

[20] Proposed rule 150.4(b)(9), Aggregation of Positions, 78 Fed. Reg. at 68,978.

[21] *See* Letter from Stuart J. Kaswell, Executive Vice President and Managing Director, General Counsel, Managed Funds Association, to David A. Stawick, Secretary, Commodity Futures Trading Commission (Jun. 28, 2012), *available at* https://www.managedfunds.org/wp-content/uploads/2012/06/MFA-Position-Limit-Aggregation-final-6-28-12.pdf. This letter was submitted in response to the Commission's 2012 aggregation proposal. Aggregation, Position Limits for Futures and Swaps, 77 Fed. Reg. 31,767 (proposed on May 30, 2012).

[22] Aggregation of Positions, 78 Fed. Reg. at 68,961. The Commission clarified that the sharing between entities of attorneys, accountants, risk managers, compliance and other mid- and back-office personnel "would generally not compromise independence so long as the employees do not control, direct or participate in the entities' trading decisions." *Id*. at 68,962. The Commission further stated: "Similarly, sharing of board or advisory committee members, research personnel or sharing of employees for training, operational or compliance purposes would not result in a violation of the criteria if the personnel do not influence (e.g., 'have a say in') or direct the entities' trading decisions." *Id.* (emphasis added).

[23] 1979 Aggregation Policy, 44 Fed. Reg. 33,839, 38,844 (June 13, 1979).

MFA agrees that the sharing of research as to market fundamentals, or technical indicators, does not itself constitute a trading decision or the exercise of trading control. The sharing of non-trading personnel, such as non-trading research personnel allows for operating efficiencies and administrative convenience and does not create a substantial risk that the affiliated entities will knowingly create a large speculative position. As a result, disaggregation should be allowed when the research personnel do not have trading control over either entity, are not making trading recommendations for one entity based on its knowledge of the positions of the other entity, and the trading programs of the related entities have been separately developed and independently implemented. MFA appreciates that the Commission has clarified its stance on this issue; however, MFA requests that the Commission further clarify that the requirement that research personnel "do not influence (e.g., 'have a say in') or direct the entities' trading decisions" is properly interpreted to mean that research personnel are not precluded from providing market research, including, for example, market fundamentals or technical indicators, support or resistance levels, and trade recommendations, so long as such personnel do not direct or control trading decisions.

MFA welcomes the Commission's new willingness to consider disaggregation relief for persons that own more than 50 percent of an owned entity, and believes that a specific policy under which Commission staff may grant relief is appropriate for these entities. However, as discussed below, MFA has concerns about some of the terms and conditions of the proposed disaggregation rules.

B. MFA Recommendations

1. The 10% Threshold for Aggregation Should Be Increased to 25% in the Context of a Passively-Owned Operating Company for Disaggregation Relief to Be Meaningful

The Commission's rules provide that any person owning a 10 percent or greater ownership or equity interest in an owned entity must aggregate its positions with those of the owned entity, absent applicable relief. Fundamentally, MFA believes that a passive ownership interest in operating companies should be exempted from the Commission's aggregation rules absent other indicia of common trading control. A passive owner of an operating company should not be required to investigate into the trading activity of an owned-operating company, and, a small passive owner will find it very difficult to do so and to obtain the information required by the Commission to satisfy the disaggregation criteria under proposed rule 150.4(b)(2) because small passive owners are not large or important enough to garner the attention of the operating company. Thus, as a practical matter, most small passive owners in operating companies will not be able to avail themselves of the relief under proposed rule 150.4(b)(2). MFA believes that to provide meaningful disaggregation relief to passive owners of operating companies, the Commission should increase the 10 percent aggregation threshold to 25 percent with respect to passive ownership in an owned operating company.

The Commission has articulated its concerns that an ownership or equity interest of 10 percent or greater in an account or position that is controlled by another person who makes discretionary trading decisions "results in control over trading or can be used indirectly to create a large speculative position through ownership interests in multiple accounts."[24] While a 10 percent aggregation threshold may be appropriate where common trading control is present, such as when commonly-owned entities share information about trading decisions or employ the same individual(s) for the purpose of directing trades, MFA believes that these concerns are not well-founded in the context of a purely passive ownership or equity interest of less than 25 percent in an owned operating company that is independently controlled by another person and where such other indicia of common trading control are not present.

Although the Commission provides exemptive relief for entities with ownership interests greater than 10 percent under proposed rule 150.4(b)(2),[25] the requisite conditions for such relief are onerous for entities that have a low ownership or equity interest in an operating company. An owner with just over a 10 percent and up to a 25 percent ownership interest in an operating company will not possess the ability to readily garner the attention of the operating company's board of directors or control the operating company's trading decisions. As a result, such owner likely will not be able to access the necessary data to assess whether it has a potential aggregation issue because the owner is such a small shareholder. Thus, the owner will not know whether the owned entity trades in referenced contracts and will be able to make a certification to the Commission only with respect to its own activities and not that of the owned entity. On the other hand, owners of 25 percent or more of an operating company should be able to obtain the information necessary to comply with proposed rule 150.4(b)(2). Specifically, MFA suggests that the Commission adopt a 25 percent threshold for disaggregation relief for passively-owned operating companies. MFA suggests that the Commission modify proposed rule 150.4(b)(2) so that the relief would become available to an entity with an ownership interest of 25 percent or greater and up to 50 percent in an operating company (instead of the current proposal providing aggregation relief to an entity with an ownership interest of 10 percent or greater but not more than 50 percent in any type of entity).

2. Exemptive Relief for Certain Ownership of Greater than 50 Percent in an Owned Entity Should Not Be Subject to an Open-Ended Approval Period

MFA commends the Commission's willingness to allow disaggregation relief for persons where ownership in an owned entity is greater than 50 percent. MFA appreciates that the Commission's proposed rules would allow commonly-owned entities to consolidate their notice filings into one filing, so long as the scope of the filing is made clear. However, MFA is concerned that the proposed rules are unduly restrictive. MFA's concerns are described below.

The Commission's proposed rules do not establish a specified time period within which Commission staff must act on an application for relief for a greater than 50 percent owned entity and do not establish clear criteria for Commission staff to evaluate, approve or reject such applications. This aspect of the 2013 Aggregation Proposal is inconsistent with the spirit of the Dodd-Frank Act, *i.e.*, to provide transparency in the derivatives marketplace. The proposed rules

[24] Aggregation of Positions, 78 Fed. Reg. at 68,951.

[25] Proposed rule 150.4(b)(2), Aggregation of Positions, 78 Fed. Reg. at 68,976.

fail to describe the types of circumstances that would bar an entity from obtaining relief even when such entity has on its face satisfied the elements specified in the Commission's rule for this relief, instead permitting the Commission to use its "discretionary" authority to deny applicants seeking exemptive relief. MFA recommends that the Commission adopt rules that stipulate a definite review period, a clear administrative process and standard for reviewing such applications, procedures requiring staff to issue a detailed written justification for any rejection of an application for exemptive relief, and an opportunity to cure any deficiency in an application.

In the vacated position limits rules,[26] the Commission described the reasons it chose to eliminate the proposed application requirement for the enumerated disaggregation exemptions, and why it instead adopted a notice filing procedure by which exemptive relief would be effective immediately upon filing.[27] The Commission stated its belief that the new notice process "represents a less burdensome, ***yet effective***, alternative to the proposed application and pre-approval process."[28] The adoption of the notice filing process instead of the application process would "allow market participants to rely on aggregation exemptions ***without the potential delay of Commission approval***, thus lessening the burden on both market participants and the Commission to respond to such applications," yet still providing the Commission with the authority to make calls for information to ensure compliance with the conditions for disaggregation relief.[29] MFA believes that these same considerations and policies should apply to the exemptive relief available to a person applying for relief with respect to a greater than 50 percent owned entity, and urges the Commission to adopt a notice filing procedure applicable to such relief.

MFA notes that the Commission permits a notice filing procedure in a number of contexts, including filings for hedge exemptions. The Commission's proposed *bona fide* hedging exemption is self-executing, with no indefinite review period. Rather, all that is required of a *bona fide* hedger is compliance with the recordkeeping requirements and Part 19 reporting obligations.[30] Additionally, under the Commission's proposed rules, certain hedgers would be required to submit a form ten days before they exceed the position limits. The proposed rules would require the submission of Form 704 ten days before exceeding the current position limits of those hedgers wishing to rely on the *bona fide* hedging exemption as it relates to hedges of: (1) unfilled anticipated requirements; (2) unsold anticipated production; (3) anticipated royalties; or (4) services.[31]

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[26] Position Limits for Futures and Swaps, 76 Fed. Reg. 71,626 (adopted Nov. 18, 2011) (vacated by *International Swaps and Derivatives Association v. United States Commodity Futures Trading* Commission, 887 F.Supp.2d 259 (D.D.C. 2012).

[27] Position Limits for Futures and Swaps, 76 Fed. Reg. at 71,654.

[28] *Id.* (emphasis added).

[29] *Id.* at 71,654-55 (emphasis added).

[30] Proposed rule 150.5(a)(2)-(3), Position Limits for Derivatives, 78 Fed. Reg. 75,680, 75,828 (proposed Dec. 12, 2013).

[31] Proposed rule 150.5(a)(1)(i), Position Limits for Derivatives, 78 Fed. Reg. at 75,828-29.

MFA recommends that the Commission implement a similar procedure for persons owning greater than 50 percent in an owned entity that seek exemptive relief by permitting such persons to submit a notice filing ten days before they begin to disaggregate their positions. Under this procedure, the Commission would continue to possess the authority to make calls for information pursuant to proposed rule 150.4(c)(3).[32] By instituting a ten-day notice submission procedure, the Commission would give market participants certainty as to the date on which they could begin to disaggregate their positions, establish a less burdensome process for all parties, and act in a manner consistent with the spirit of the Dodd-Frank Act and Commission precedent. MFA encourages the Commission to consider and implement this recommendation.

Alternatively, in the event that the Commission determines not to establish a ten-day notice submission procedure, then MFA requests the Commission to establish a prescribed time period for the staff review of applications for exemptive relief filed pursuant to proposed rule 150.4(c)(2). Providing for a specified review period is not unusual or unique. For example, pursuant to CFTC Rule 40.5, when a registered entity files a rule amendment for Commission approval, the rule amendment is "deemed approved by the Commission under section 5c(c) of the Act 45 days after receipt by the Commission."[33] The Commission also provides stipulated review periods for foreign boards of trade that submit certain products to the Commission for its approval. Pursuant to CFTC Rule 30.13, a foreign board of trade may request expedited review of a product submission under certain conditions.[34] The expedited review consists of a 45-day review period after which the product is "deemed to be in conformance" with the Act.[35] Yet another example of a specified review period is in CFTC Rule 40.10, which provides for a 60-day review period for rule changes proposed by systemically important derivatives clearing organizations that "could materially affect the nature or level of risks presented by [such clearing organization]."[36] Pursuant to CFTC Rule 40.10, the Commission may request "further

[32] Proposed rule 150.4(c)(3) states: "Upon call by the Commission, any person claiming an aggregation exemption under this section shall provide such information demonstrating that the person meets the requirements of the exemption, as is requested by the Commission. Upon notice and opportunity for the affected person to respond, the Commission may amend, suspend, terminate, or otherwise modify a person's aggregation exemption for failure to comply with the provisions of this section." Aggregation of Positions, 78 Fed. Reg. at 68,978.

[33] 17 C.F.R. 40.5(c). The regulation further provides that the Commission may extend the review period for: (1) an additional 45 days if the proposed rule amendment raises "novel or complex issues that require additional time for review or is of major economic significance" or (2) any period beyond the additional 45 days to which the registered entity agrees in writing. 17 C.F.R. 40.5(d).

[34] 17 C.F.R. 30.13(e).

[35] 17 C.F.R. 30.13(g). Similar to the "novel or complex" extension for rule submissions made pursuant to CFTC Rule 40.5, the Commission may extend the 45-day review period under CFTC Rule 30.13 for an additional 45 days or for any period the foreign board of trade requests in writing. 17 C.F.R. 30.13(h).

[36] 17 C.F.R. 40.10(a). Under CFTC Rule 40.10, a systemically important clearing organization ("**SIDCO**") may ask for expedited approval on the grounds that the change would materially decrease risk. Thus, the 60-day review period may be shortened by such a request, or when the Commission notifies the SIDCO in writing that it has "no objection" to the proposed rule change (which may be done at any point during the 60-day review period). 17 C.F.R. 40.10(e)-(g).

information" about the rule change, which has the effect of stopping the 60-day review period and restarting it anew upon the Commission's receipt of the requested further information.[37]

The lack of a specified time period for the review of an application for exemptive relief is contrary to the procedures that the Commission has adopted in other regulatory contexts, and fails to provide adequate transparency to applicants.

MFA also is concerned that the Commission may choose not to exercise its authority pursuant to proposed rule 150.4(b)(3). In the 2013 Aggregation Proposal, the Commission states that "relief would be available ***only if and when*** the Commission acts on a particular request for relief."[38] Thus, it appears that the Commission may determine to not exercise its authority to grant relief even when an entity satisfies all of the criteria that the Commission has set forth in the proposed rule. The Commission should specify in its rules the types of circumstances under which the Commission would choose not to exercise its authority to grant relief.

3. The Commission Should Provide Clear Guidance on the Manner it Will Review Requests for Exemptive Relief Made Pursuant to Section 4a(a)(7) of the Act

MFA appreciates that an entity with a greater than 50 percent ownership interest in an owned entity that fails to satisfy the Commission's regulatory criteria pursuant to proposed rule 150.4(c)(2) may seek relief from aggregation under section 4a(a)(7) of the Act. This section of the Act grants to the Commission the authority to provide relief from the speculative position limits regime. The Commission specifically requested comments on the facts and circumstances that it should consider during its review of requests made pursuant to section 4a(a)(7) of the Act.[39] MFA believes that relief from aggregation under section 4a(a)(7) of the Act should be available to persons with greater than 50 percent ownership of owned entities who cannot meet the conditions in proposed rule 150.4(b)(3), but notes that the same concerns described above are present under this proposal, namely: (i) the lack of a specific time period for Commission staff to review and act on an application for relief; and (ii) the discretionary basis for granting or denying relief with no description of the factors the Commission may consider to be relevant in determining whether to grant relief.

For this relief to be meaningful, the Commission should adopt substantive guidance for staff to follow during its review of any request made pursuant to section 4a(a)(7) of the Act. The guidance should include staff adherence to a specified review period when considering requests for relief made pursuant to section 4a(a)(7) of the Act. Also, the guidance should include factors relevant to trading control. In determining whether to grant relief, the most important criterion the Commission should consider is whether the entity with the ownership

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[37] 17 C.F.R. 40.10(c).

[38] Aggregation of Positions, 78 Fed. Reg. at 68,960 (emphasis added).

[39] Aggregation of Positions, 78 Fed. Reg. at 68,965 ("Also, what are the facts and circumstances that commenters believe would justify relief under CEA section 4a(a)(7)?").

interest actually controls or directs the trading decisions of the owned entity. If the trading decisions of the owner and the owned-entity are made independent of one another, then those entities' positions should not be aggregated. The absence of common trading control amongst the entities should be the determining factor in the Commission's decision to grant relief. Where the owner of an owned entity can demonstrate independence of control, the Commission should grant disaggregation relief.

4. Exemptive Relief for Certain Ownership of Greater than 50 Percent in an Owned Entity Should Not be Conditioned on Any *Bona Fide* Hedging Requirements or a 20 Percent Limit on Speculation

MFA respectfully recommends that the Commission eliminate the condition that either: (i) all of the owned entity's positions qualify as bona fide hedging transactions; (the "***Bona Fide* Hedging Condition**") or (ii) the owned entity's positions that do not so qualify do not exceed 20 percent of any position limit currently in effect (the "**20 Percent Limit Condition**") for relief from aggregation pursuant to proposed rule 150.4(b)(3). MFA believes that the *Bona Fide* Hedging Condition may be unnecessary because *bona fide* hedging transactions already are exempt from speculative position limits. Moreover, it is difficult to comment on this condition because the definition of *bona fide* hedging is unclear at this point in light of the Commission's recently proposed amendments to the definition of *bona fide* hedging,[40] and, therefore, MFA urges the Commission to reconsider this condition once it finalizes the definition of *bona fide* hedging.

Regarding the 20 Percent Limit Condition, MFA is concerned that it would unnecessarily restrict the ability of fund managers to diversify their investment strategies. Investors hire fund managers to invest their assets, and to diversify their economic risk exposure by applying multiple investment strategies. A fund manager may invest in separately managed trading strategies, and/or invest in independently managed operating companies. The 20 Percent Limit Condition likely would unduly constrain a fund manager's investments in owned entities, such as affiliated funds or independently managed operating companies. The Commission has not explained the reasons it deems the alternative conditions in proposed rule 150.4(b)(3) to be necessary or how it determined that the 20 percent level is the appropriate cap on speculative positions. Given the requirement that an owned entity demonstrate independence of trading control between it and the owner, the *Bona Fide* Hedging Condition and the 20 Percent Limit Condition appear to be arbitrary and unnecessary.

[40] Position Limits for Derivatives, 78 Fed. Reg. 75,680, 75,706 (proposed Dec. 12, 2013) (describing the proposal to delete Rule 1.3(z), the current definition of *bona fide* hedging, and replace it with a new definition of "*bona fide* hedging position" in proposed rule 150.1).

5. Exemptive Relief for Certain Ownership of Greater than 50 Percent in an Owned Entity Should Permit Consolidation of the Financial Statements of the Owner

The Commission solicited comments on financial consolidation related to certain ownership of greater than 50 percent in an owned entity. Specifically, the Commission asked whether it is appropriate "to condition such relief on the owned entity not being, and not being required to be, consolidated on the financial statements of the owner."[41] The Commission asked whether financial consolidation is a "relevant consideration in this regard" or a "useful proxy for other characteristics that are relevant to the position limits regime, such as ownership and control."[42] The Commission has not, however, made clear its policy basis for this condition. MFA believes that a consolidated financial statement is not relevant to the determination of whether one entity controls another entity's trading decisions.

MFA contends that financial consolidation is not a useful proxy for relevant considerations related to disaggregation and, as a result, recommends that the Commission eliminate this condition from the final rules. Despite the fact that financial statements of affiliated entities may be consolidated, there is no reason necessarily to assume that one entity controls the other consolidated entities' trading decisions. In fact, consolidation does not mean that the company that consolidated the other company operates the consolidated company. To avoid a court's "piercing the corporate veil" and holding a parent liable for the subsidiary's obligations, parents and subsidiaries operate separately. If a parent company made day to day decisions for its subsidiary, such as decisions relating to the subsidiary's trading activities, the parent would run the risk of a court piercing the corporate veil and holding the parent responsible for the subsidiary's obligations. Accordingly, generally parents do not make day to day decisions for their subsidiaries. Furthermore, parents have no ability to access the resources of their consolidated entities unless the consolidated entity first satisfies its creditors and lenders. Consolidation is not based on the exercise of day to day control over another entity or the ability of a parent to have ready access to the subsidiary's resources.

Consolidation is required by generally accepted accounting principles ("**GAAP**") when an entity has a controlling financial interest in another entity.[43] Generally, a controlling financial interest is based on equity ownership of more than 50% of the other entity's equity. A controlling financial interest can also be found for accounting purposes even when a parent does not have equity in the other entity. Consolidation may be required based on contractual relationships, a court decree, or the obligation of an entity to absorb expected losses or receive expected residual returns of a legal entity, such as a variable interest entity. In the case of limited partnerships, a general partner may be required to consolidate the limited partnership based on its operational responsibilities for the limited partnership even though the general partner has no equity interest in the limited partnership.

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[41] Aggregation of Positions, 78 Fed. Reg. at 68,963.

[42] *Id*.

[43] Financial Accounting Standards Board Accounting Standards Codification ("**ASC**") PART 810, "Consolidation."

Given the various different requirements in GAAP relating to consolidation, the basic consolidation requirement for a controlling financial interest, and the legal requirement that companies operate subsidiaries and other consolidated entities separately to avoid a court holding that the parent is responsible for the subsidiary's obligations, we believe that consolidation is not relevant to the objectives of this proposal. Consolidation does not imply that there is common trading control amongst the entities. The critical issue for position limit aggregation is whether there is *de facto* common trading control. The consolidation of financial statements is irrelevant and not conclusive to the determination of the presence or absence of de facto trading control. Therefore, the fact that a company is reflected for accounting purposes in another entity's consolidated financial statements should not disqualify an entity that has a greater than 50 percent ownership interest in another entity from obtaining disaggregation relief.

6. The Restriction on Passive Ownership of Greater than 25 Percent of Pools Operated by a CFTC Rule 4.13 Exempt CPO Should be Eliminated

Commission rules currently provide for exemptive relief from aggregation for limited partners, limited members, shareholders or other similar types of pool participants, with certain conditions.[44] Proposed rule 150.4(b)(1)(iii) retains the current condition that does not provide disaggregation relief for a passive investor that holds a direct or indirect 25 percent or greater ownership or equity interest in a commodity pool where the operator of the pool is exempt from registration under CFTC Rule 4.13.[45] MFA respectfully requests that the Commission eliminate this restriction from the final rule or in the alternative, eliminate the restriction with respect to CFTC Rule 4.13(a)(3) exempt pools.

As stated previously, trading control is the most important factor to consider when determining whether disaggregation relief is appropriate. A limited partner, limited member, shareholder or other passive pool participant has only a *passive* investment and, as a result, does not possess the ability to control or direct the owned entity's trading decisions. When an owner is a passive owner, it should not be required to aggregate positions, regardless of such owner's ownership interest. An ownership interest greater than 25 percent, especially in this context, does not demonstrate trading control. Accordingly, this restriction should be eliminated from the final rules, which instead should focus on actual trading control.

The ownership restriction for passive investors in a commodity pool should be removed from the final rules for other important reasons. Before CFTC Rule 4.13(a)(4) was rescinded, the passive ownership condition may have been logical because CFTC Rule 4.13(a)(4) exempt pools had no restrictions on the amount of commodity interests in which they could invest. However, there is no need to apply this restriction to funds that rely on CFTC Rule 4.13(a)(3), which by definition are permitted only to invest in a *de minimis* amount of commodity interests, *i.e.*, a 5% initial margin limitation, or a 100% net notional value limitation, which should protect against concerns about excessive speculation by such funds.

[44] 17 C.F.R. 150.4(c).

[45] Proposed rule 150.4(b)(1)(iii), Aggregation of Positions, 78 Fed. Reg. at 68,976.

Further, in the case of a fund of funds, investment managers of underlying investee funds are generally unwilling to provide to the manager of a fund of funds the type of detailed portfolio information that such manager would need to monitor compliance with the aggregation rules. In fact, in response to a request[46] by MFA and the Investment Adviser Association relating to registration and exemption questions in the fund of funds context, the Commission acknowledged this problem. The Commission noted that, for a manager of a fund of funds, there may be a "lack of visibility…regarding the positions of an Investee Fund" and that "such opaqueness" may not allow such manager to perform the direct calculations required to determine whether it qualifies for an exemption from CPO registration.[47] Further, even those investment managers of underlying investee funds that provide full position-level transparency to the manager of a fund of funds rarely (if ever) do so on a real-time basis. As a result, even if the manager of a fund of funds could look through to the positions of underlying investee funds, it would be virtually impossible for it to do so on a real-time basis. Thus, there is a potential for an inadvertent violation of the 25 percent condition.

Moreover, the monitoring of ownership percentages in a pool is burdensome, impractical and creates a potential trap for investors who may unintentionally violate the 25 percent limit. Many commodity pools offer investors the opportunity to contribute capital and make withdrawals on a quarterly or monthly basis, and in some instances, more frequently. As a result, the investor, who has no investment discretion and whose investment in the commodity pool has not changed, could unwittingly violate position limits due to the required aggregation. The effect would be to severely limit the investor's ability to diversify its allocations and meet any obligations to its underlying customers.

MFA recommends that the Commission reconsider this policy as it is unnecessary to apply it to CFTC Rule 4.13 exempt pools in light of the rescission of CFTC Rule 4.13(a)(4) and will have the practical effect of creating a trap for passive investors. Specifically, MFA requests that the Commission eliminate clause (iii) of proposed rule 150.4(b)(1). The Commission should not treat passive investments in a 4.13(a)(3) exempt pool differently from passive investments in other pools for purposes of disaggregation relief. A passive investor in a commodity pool (whose operator and manager is unaffiliated with the investor), including pools operating pursuant to a CFTC Rule 4.13 exemption – who has no investment control over the fund in which it invests and, thus, has no ability to distort or manipulate the market – should be permitted to exceed 25 percent ownership.

[46] MFA and Investment Adviser Association, Request for Delayed Compliance Date of Amended Part 4; Former Appendix A of the CFTC's Part 4 Regulations, 17 CFR Part 4 (Nov. 9, 2012), *available at* https://www.managedfunds.org/wp-content/uploads/2012/11/IAA-MFA-Comment-Letter-to-CFTC-re-Extension-of-Compliance-Date-of-Former-Appendix-A-11-9-12.pdf.

[47] MFA and Investment Adviser Association, CFTC No-Action Letter (Nov. 29, 2012), *available at* http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/12-38.pdf.

7. Owned Entity Relief Should be Available to Partnerships

Proposed rules 150.4(b)(2) and 150.4(b)(3) provide exemptive relief from aggregation for persons with an ownership or equity interest in an owned entity of (i) 10 percent up to and including 50 percent; and (ii) greater than 50 percent, respectively. However, the proposed rules do not allow partnerships to be eligible for owned entity disaggregation relief.[48] The Commission states that a partnership could not satisfy the condition for owned-entity relief that requires information barrier procedures.[49] The Commission paints with too broad a brush in this respect. The Commission's position appears to be based on certain over generalizations regarding the control of partnerships, and it fails to consider that some partners do not possess actual control over the trading decisions of the partnership or information or knowledge about the partnership's trading decisions.[50] The Commission automatically disqualifies all partnerships and natural persons from availing themselves of owned-entity disaggregation relief.

The positions of two entities should not be aggregated simply because there are non-trading personnel or owners (including general partners) that may have the right to obtain information about the positions of both entities, provided that such individuals do not actually exercise their right to obtain and do not obtain position level information about the affiliated entities, and have no actual control or do not exercise any de facto control over the trading decisions of either entity. The absence of common trading control should be the determining factor in granting disaggregation relief and, where no such control actually exists, such relief should be granted. MFA respectfully requests the Commission to revise its stance on the issue of partnerships and natural persons to permit partnerships or individual general partners to seek relief pursuant to the Commission's owned entity exemptions from aggregation.

8. A *Pro Rata* Aggregation Approach Should Be Adopted

In the event that aggregation is required due to common ownership and the affiliated entities do not qualify for disaggregation relief, MFA believes that it is appropriate to use a *pro rata* aggregation of the position based on the person's ownership interest in the owned entity, rather than aggregating 100 percent of the owned entity's position with the owner's positions. For example, where Company A owns 40% of Company B, and Company B owns 1,000 contracts in a reference commodity, 400 contracts would be attributed to Company A and all

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[48] Aggregation of Positions, 78 Fed. Reg. at n. 113, 68,960 ("It is impossible for a natural person or a partnership to satisfy the criterion that the person does not control the trading of the owned entity, with the person showing that it and the owned entity have procedures in place that are reasonably effective to prevent coordinated trading in spite of majority ownership, because "it is not possible separate knowledge and control of the person from that of the owned entity.").

[49] *Id.*

[50] *See, e.g., id.* Moreover, the Commission's proposed rules, which prohibit the consolidation of financial statements of owned entities seeking disaggregation relief, explain that a limited partner holding a greater than 50 percent ownership interest in a limited partnership could qualify for relief because a limited partnership "is controlled by the general partner." Again, the Commission does not consider that a particular individual general partner may not control trading decisions or have information related to trading decisions. Aggregation of Positions, 78 Fed. Reg. at 68,960.

1,000 contracts would be attributed to Company B. The Commission's aggregation scheme should be based on proportionality and should not unnecessarily limit trading or investment decisions of traders and other market participants. A *pro rata* aggregation approach attributes a quantity of contracts in proportion to the ownership interest of a person in an owned entity, thus reflecting the beneficial ownership of the owner while still achieving the Commission's stated goal of preventing evasion of prescribed position limits.[51] Moreover, *pro rata* aggregation minimizes "double counting" of positions and artificial limits on trading that could adversely affect liquidity that otherwise would be caused if 100% of the owned entity's positions were attributed to the owner and to the owned entity.

The implementation of a *pro-rata* aggregation regime would not be unduly burdensome on the owner of the owned entity or on the Commission. The adoption of *pro rata* aggregation will require that the owner know the quantity of the position owned by the owned entity to enable it to calculate the *pro rata* percentage that should be attributed to the owner. The Commission will have this information by virtue of large trader reporting and its ability under Form 40 and under its special call authority to obtain information related to the ownership interest of the owner in the owned entity. MFA recommends using these procedures to obtain ownership interest information because they are well-established and not overly burdensome on either the owner or the Commission.

* * * * *

We appreciate the opportunity to offer suggestions to the 2013 Aggregation Proposal. We would be happy to discuss our comments or any other issues raised in the 2013 Aggregation Proposal at greater length with the Commission or its staff. If the staff has any questions, please do not hesitate to contact Jennifer Han or the undersigned at (202) 730-2600.

Respectfully submitted,

/s/ Stuart J. Kaswell

Stuart J. Kaswell
Executive Vice President & Managing Director,
General Counsel

Cc: The Hon. Mark Wetjen, Acting Chairman
The Hon. Scott O'Malia, Commissioner
The Hon. Bart Chilton, Commissioner
Mr. Stephen Sherrod, Senior Economist, Division of Market Oversight

[51] Aggregation of Positions, 78 Fed. Reg. at 68,969.

Alternative Investment Management Association

Melissa D. Jurgens
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW.
Washington, DC 20581

Submitted via http://comments.cftc.gov

RIN number 3038–AD82

10 February 2014

Dear Ms Jurgens,

Aggregation of Positions; Proposed Rule

The Alternative Investment Management Association (**AIMA**)[1] welcomes the opportunity to respond to the Commodity Futures Trading Commission's (**the Commission**) proposed rule on aggregation of positions (**Proposed Rule**).[2]

As a general comment, we note that the Proposed Rule includes a number of modifications to the approach set out in the prior, now vacated, proposals to amend part 151 of the Commission's regulation, which were published in May 2012 (hereafter: **2012 Aggregation Proposal**).[3] We welcome many of the changes that have been made, which we believe will provide market participants with greater certainty as to the application of the rules.[4] In particular, we strongly endorse the proposed exemption from aggregation for ownership by limited partners, shareholders or other pool participants (150.4(b)(1)).

At the same time, there are elements of the rules that we believe could be helpfully refined further:

- We encourage the Commission to revise its approach to ensure that persons who may act as Independent Account Controllers ("IACs") to include all commodity trading advisors ("CTAs"), not only registered CTAs, as well as exempt CPOs. Current regulations provide that certain persons excluded from the definition of the term commodity pool operator ("CPO") may be IACs and the Commission is proposing to expand that group of persons. We believe that CTAs exempt from registration in accordance with the statutory exemptions under Section 4m(1) or 4m(3) of the Commodity Exchange Act ("CEA"), or who have filed a notice of exemption under CFTC Regulation 4.14(a)(8), should be able to act as an IAC. For our members, it will also be important that CTAs exempt from registration under the CEA in accordance with CFTC Regulation 3.10(c)(3) be able to act as an IAC. These non-registered CTAs will be subject to the notice filing required of other IACs, so the Commission will have knowledge of who is acting as an IAC.

- It would be helpful to introduce a grace period of 75 days from the initial compliance date in respect of the owned entity exemption, permitting firms to avail themselves of this exemption if they are in the process of making an exemption claim. This would address the difficulty that is otherwise caused by the fact that "the exemption from aggregation would not be effective retroactively because the filing is a pre-requisite to the exemption."[5]

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1 Founded in 1990, AIMA is the global representative of the hedge fund industry. We represent all practitioners in the alternative investment management industry – including hedge fund managers, fund of hedge funds managers, prime brokers, legal and accounting firms, investors, fund administrators and independent fund directors. Our membership is corporate and comprises over 1,300 firms (with over 7,000 individual contacts) in more than 50 countries. See www.aima.org.

2 Proposed Rule 78 FR68946: 17 CFR Part 150 Aggregation of Positions.

3 Proposed Rule 77 FR 31767: 17 CFR Part 151 Aggregation, Position Limits for Futures and Swaps.

4 We refer in this submission to the comments that AIMA made previously in its response to the 2012 Aggregation Proposal, referred to hereafter as the **July 2012 submission**. The July 2012 submission is filed with Comment Number 58303.

5 78 FR 68962.

AIMA would, of course, be happy to discuss the points raised in this submission further. Please contact Adam Jacobs or myself on +44 20 7822 8380 if you have any questions.

Yours sincerely,

Jiří Król
Deputy CEO
Head of Government & Regulatory Affairs

Annex 1

1. **Aggregation of positions**

Ownership stakes in investment managers

While we welcome the feedback provided by the Commission in the Proposed Rule, our members would appreciate further guidance on the extent to which an investment manager ("Entity 1") is required to aggregate the positions held in the client accounts that it controls with the client accounts controlled by a separate manager ("Entity 2") in which it has an ownership stake of greater than 50% (assuming that the two investment managers are acting independently of one another and have no control of the trading of or positions controlled by the other). Our understanding is that Entity 1 would not be required to aggregate the positions in client accounts controlled by Entity 2, as, taking the wording from 150.4(a)(1) of the Proposed Rule, Entity 1 does not have an "ownership or equity interest" in those accounts (only in Entity 2 itself) and does not control the trading of those accounts. We would welcome confirmation from the Commission that this reading of the Proposed Rule is correct.

Substantially identical trading strategies

Proposed rule 150.4(a)(2) would track the vacated rule 151.7(d), with the addition of the word "substantially," so that irrespective of any ownership threshold, trading positions in more than one account or pool with "substantially identical trading strategies" must be aggregated. Our understanding is that proposed rule 150.4(a)(2) will primarily be relevant for passively managed index funds. However, given the qualification of the language through the addition of "substantially", it would be helpful if the Commission could provide further guidance on the situations that will be covered by proposed rule 150.4(a)(2) and, specifically, whether the Commission believes that there are situations in which this might be relevant for entities other than index funds. Similarly, we understand that, according to the proposed rule, accounts placed in separate performance composites would not be treated as having substantially identical trading strategies.

We further note that the term "trading strategies" is not defined in the regulatory text or described in the preamble. The term "trading program" is defined in Regulation 4.10(g) and it may be preferable to use that defined term in this context. If the Commission has something else in mind, it would be helpful to provide further guidance in the regulatory text as to the meaning of "substantially identical trading strategies" and whether that could apply to entities other than index funds. At the very least, some additional description of the application of the phrase "substantially identical trading strategies" in the preamble of the final regulations would be valuable in enabling our members to comply with the regime.

2. **Exemptions**

2.1 Exemption for pool participants

The Proposed Rule establishes an exemption from aggregation for ownership by limited partners, shareholders or other pool participants (150.4(b)(1)), something that AIMA strongly supports. We believe that it would be reasonable to extend this exemption to include the beneficiary of a trust. Further, we believe that this exemption would benefit from drafting amendments to clarify:

- That the reference to "limited member" is to a person who is not a managing member;[6]
- That the reference to the commodity pool operator of the pooled account under proposed rule 150.4(b)(1)(i) should be construed as a reference to the person discharging the function of commodity pool operator, to account for situations where the function has been delegated from one person to another.

We further understand that an entity does not need to make a relief filing in order to rely on this exemption, unless seeking to rely on the exemption for principals/affiliates of the operator of the pooled account in accordance with 150.4(b)(1)(ii); we would be grateful if the Commission could provide confirmation of this.

2.2 Owned entity exemption

As a general comment, we note that the Commission has adopted a number of helpful changes and clarifications to the owned entity exemption in comparison with the 2012 Aggregation Proposal. We comment in detail on the criteria below, but would also highlight our view that the criteria should be designed in such a way as make the

[6] We note that the Limited Liability Company Act of the State of Delaware does not include the defined concept "limited member".

investor, rather than the owned entity, primarily responsible for ensuring that appropriate controls exist to prevent sharing of position information.

We further believe that there is a strong case for revisiting the 10% threshold, particularly for passive investments in operating companies (as can be seen in the fund of funds context), and believe that 25% would be a more appropriate threshold in this context.

Knowledge of the trading decisions

Proposed rule 150.4(b)(2)(i)(A) would condition aggregation relief on a demonstration that the person filing for aggregation relief and the owned entity do not have knowledge of the trading decisions of the other. In line with our comment above, we believe that this condition should be reframed so as to ensure that it is the person filing for aggregation relief, rather than the owned entity, that has primary responsibility for developing and administering the necessary controls. This will help ensure that the regime is proportionate, whilst delivering its objectives.

Separately developed and independent trading systems

Proposed rule 150.4(b)(2)(i)(B) would condition aggregation relief on a demonstration that the person seeking disaggregation relief and the owned entity trade pursuant to separately developed and independent trading systems. In our July 2012 submission, we queried proposed requirements in respect of "separately developed systems", given the prevalence of off-the-shelf systems that are used by investment managers to execute orders. We therefore welcome the Commission's statement that it "does not expect that this criterion would prevent an owner and an owned entity from both using the same "off-the-shelf" system that is developed by a third party".[7]

At the same time, we believe it would be helpful to consider further what this criterion might mean in situations where the person seeking disaggregation relief and the owned entity use systems which are based at least in part on shared architecture (*i.e.* their trading software might have in common programming that has been developed in-house, rather than acquired on licence), and yet nevertheless have completely separate trading strategies. We believe that the key test is whether the entities are running distinct trading strategies, rather than whether the software is completely distinct. We believe that when in-house software is being used to pursue separate trading strategies, it should be considered to be "separately developed and independent".

Written procedures

Proposed rule 150.4(b)(2)(i)(C) would condition aggregation relief on a demonstration that the person seeking relief and the owned entity have, and enforce, written procedures to preclude the one entity from having knowledge, or gaining access to, or receiving data about, trades of the other. Such procedures must include document routing and other procedures or security arrangements, including separate physical locations, which would maintain the independence of their activities. In our July 2012 submission, AIMA encouraged the Commission to provide additional guidance on the application of the terms "document routing" and "separate physical locations". The Proposed Rule explains that separate physical locations would not necessarily require personnel to be located in separate buildings, but that there should be a physical barrier between the personnel that prevents access between the personnel that would impinge on their independence (the Commission notes that this could include locked doors, rather than merely separate desks). In line with our comment above, we believe that the owner should have primary responsibility for ensuring that appropriate controls exist, in order to ensure the proportionality of the regime.

Shared employees

Proposed rule 150.4(b)(2)(i)(D) would condition aggregation relief on a demonstration that the person does not share employees that control the owned entity's trading decisions, and the employees of the owned entity do not share trading control with such persons. We welcome confirmation from the Commission that "the sharing of attorneys, accountants, risk managers, compliance, and other mid- and back-office personnel […] would generally not compromise independence so long as the employees do not control, direct or participate in the entities' trading decisions."[8] While it is helpful to specify the types of roles that might be relevant in this regard, it is also worth bearing in mind the difficulty of providing an exhaustive list of the categories of employees that should not be considered to exercise control over the entities' trading decisions; accordingly, we would welcome

[7] 78 FR 68962.
[8] 78 FR 68962.

confirmation from the Commission that the categories of employees set out in the Proposed Rules are not intended to be restrictive. For example, it is conceivable that firms could share sales staff without leading to knowledge of the other's trading decisions.

Risk management systems

Proposed rule 150.4(b)(2)(i)(E) would condition aggregation relief on a demonstration that the person and the owned entity do not have risk management systems that permit the sharing of trades or trading strategies with the other. We believe that this criterion could be refined in order to take into account whether the individuals who have access to such risk management systems exercise control over trading decisions. If they do not exercise control over trading decisions, then we believe that there is no need to restrict the sharing of trades or trading strategies via shared risk management systems.

2.3 Exemption for Ownership of Greater Than 50 Percent

We note that proposed rule 150.4(b)(3) would permit a person with a greater than 50 percent ownership of an owned entity to apply to the Commission for relief from aggregation on a case-by-case basis. We view this as a welcome change relative to the Commission's 2012 Aggregation Proposal, and believe that it will help to ensure that relief from aggregation is available in appropriate situations.

The Commission sets out the criteria that will need to be met in order to qualify for case-by-case relief, which include the requirement that the "owned entity is not required to be, and is not, consolidated on the financial statement of the person" (proposed rule 150.4(b)(3)(i)). We note that consolidation of an owned entity on the financial statement of the owner will not necessarily entail sharing of position information in all situations. Even when consolidation does lead to sharing of information, this does not necessarily imply that the information is available to those employees who are responsible for trading decisions. Accordingly, we believe that this criterion could be helpfully modified so that it does not exclude the possibility of balance sheet consolidation, and only restricts the availability of the exemption to the extent that consolidation leads to sharing of information between the persons who have control over trading decisions (paralleling the shared employees criterion more closely).

We further encourage the Commission to revise the framework for filing for an exemption under 150.4(b)(3) in order to provide a specific timeframe within which the Commission would grant or refuse an exemption. A short review period would be preferable, in order to maximize certainty for market participants seeking relief.

2.4 Independent Account Controller for Eligible Entities

In our July 2012 submission, we expressed our concern that the exemption for Independent Account Controllers ("IACs") would not be available to foreign investment funds that are not structured as limited liability companies or limited partnerships. We therefore welcome the Commission's approach under proposed rule 150.4(b)(5), whereby the exemption will be available to any person "with a role equivalent to a general partner in a limited liability partnership or a managing member of a limited liability company".[9] This will ensure that the regime does not unfairly disadvantage foreign investment funds that are not structured as limited liability companies or limited partnerships.

At the same time, however, we encourage the Commission to revise its approach to ensure that persons who may act as IACs include all commodity trading advisors ("CTAs"), not only registered CTAs, as well as exempt CPOs. We believe that CTAs exempt from registration in accordance with the statutory exemptions under Section 4m(1) or 4m(3) of the Commodity Exchange Act ("CEA"), or who have filed a notice of exemption under CFTC Regulation 4.14(a)(8), should be able to act as an IAC. For our members, it will also be important that CTAs exempt from registration under the CEA in accordance with CFTC Regulation 3.10(c)(3) be able to act as an IAC. These non-registered CTAs will be subject to the notice filing required of other IACs, so the Commission will have knowledge of who is acting as an IAC.

For example, if an eligible entity is a collective investment vehicle that is not required to be operated by a registered CPO, we believe that there should be no requirement that a CTA trading a portion of the vehicle's assets be registered in order to take advantage of the IAC exception. Pension plan beneficiaries should not be deprived of the services of a particular CTA that is exempt from registration in accordance with the CEA and regulations thereunder because of required aggregation under the position limits rules, when such beneficiaries

[9] 78 FR 68965.

have no direct contact with the CTA and no person is required to register as a CPO to operate the plan. Further, even in situations where there is a registered CPO, we also believe that should not restrict who may act as an IAC only to registered CTAs.

2.5 Violation of laws exemption

AIMA welcomes the CFTC's proposed rule 150.4(b)(8) that establishes an exemption from aggregation of positions when the sharing of information between a person and an owned entity would create a reasonable risk that either person could violate state or federal law or the law of a foreign jurisdiction, or regulations adopted thereunder. It would be helpful if the Commission could confirm that this provision extends to supranational laws, including those promulgated by the European Union. We believe that the "reasonable risk" standard is an appropriate basis for the exemption.

In our July 2012 submission, we set out our view that a person wishing to apply the exemption should supply "supporting legal documentation" rather than an opinion from Counsel, in order to ensure the proportionality of the regime.[10] We therefore support the Commission's amended approach that would require a "written memorandum of law explaining in detail the basis for the conclusion that the sharing of information creates a reasonable risk that either person could violate state or federal law or the law of a foreign jurisdiction, or regulations adopted thereunder". We also welcome the confirmation from the Commission that the memorandum may be prepared by an employee of the firm or its affiliates.[11]

2.6 Clarification Regarding Employee Benefit Plans

The Commission stated that it was responding to a comment "that a corporate entity that is the sponsor of an employee benefit plan should not be required to aggregate the positions of the plan with the sponsor's proprietary positions."[12] The Commission's proposed response is to treat the manager of the employee benefit plan as an IAC and the plan's positions as client positions. We request that the Commission clarify that this treatment also be applied in the case of a governmental plan or a church plan, *i.e.*, where the sponsor of the employee benefit plan may not be a corporate entity.[13] We further request a slight revision of the text of proposed Regulation 150.1(e)(5)(ii), which is intended to effect the treatment discussed above. That paragraph now refers to a "manager of a commodity pool the operator of which is excluded from registration under §4.5(a)(4)." Because most of the employee benefit plans referred to in Regulation 4.5(a)(4) are construed not to be pools for purposes of that provision, we believe that it would be clearer and more appropriate to use identical language in Regulation 150.1(e)(5)(ii) as appears in the introductory text of Regulation 150.1(d) defining the term "eligible entity." Therefore, we recommend that the phrase "commodity pool the operator of which is excluded from registration" be deleted from Regulation 150.1(e)(5)(ii) and replaced with the phrase "trading vehicle which is excluded, or which itself has qualified for exclusion from the definition of the term 'pool' or 'commodity pool operator,' respectively," the latter being taken from the text of Regulation 150.1(d).

3. Filing Requirements

Proposed Rule 150.4(c) sets out the notice filing requirements associated with the aggregation framework. We note that filing requirements inevitably create a burden for the firms who are subject to them and believe that it is important to design them in such a way as to minimize this burden. We therefore welcome the Commission's approach, whereby a repeat filing is only required where there is a "material change to the information" provided in an earlier filing; this is preferable to requiring a new notice to be filed on a periodic basis. However, we believe that there is scope to refine further the filing requirements in order to ensure smooth transition to the new framework. For example, it would be helpful to introduce a grace period of 75 days from the initial compliance date in respect of the owned entity exemption, permitting firms to avail themselves of this exemption if they are in the process of making an exemption claim. This would address the difficulty that is otherwise caused by the fact that "the exemption from aggregation would not be effective retroactively because the filing is a pre-requisite to the exemption."[14]

[10] 78 FR 68965.
[11] 78 FR 68950.
[12] 78 FR 68960-61.
[13] *See* CFTC Regulation 4.5(a)(4)(iii) and (v).
[14] 78 FR 68962.

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December 20, 2013

Ms. Melissa Jurgens
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
Washington, DC 20581

Re: Aggregation of Positions Notice of Proposed Rulemaking ("Aggregation NOPR") (RIN 3038–AD82)

Dear Ms. Jurgens:

The Asset Management Group ("**AMG**")[1] of the Securities Industry and Financial Markets Association ("**SIFMA**") and the International Swaps and Derivatives Association ("**ISDA**" and collectively, the "**Trade Associations**")[2] are writing to request that the Commodity Futures Trading Commission (the "**Commission**") extend the comment period for the Aggregation NOPR[3] to align it with the end of the comment period for the Position Limits for Derivatives Notice of Proposed Rulemaking ("**Position Limits NOPR**").[4]

While the proposed rules relating to the Aggregation NOPR and Position Limits NOPR (collectively, the "**Proposed Rules**") were considered and adopted at the same Commission public meeting on November 5, 2013, nearly one month separated their publication in the Federal Register. The two Proposed Rules are deeply intertwined. There are direct links between the two proposals. The two Proposed Rules reflect the same set of statutory and policy concerns. The Position Limits NOPR articulates the Commission's underlying rationale for the

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[1] AMG's members represent U.S. asset management firms whose combined assets under management exceed $20 trillion. The clients of AMG member firms include, among others, registered investment companies, ERISA plans and state and local government pension funds, many of whom invest in commodity futures, options, and swaps as part of their respective investment strategies.

[2] ISDA's mission is to foster safe and efficient derivatives markets to facilitate effective risk management for all users of derivative products. ISDA has more than 800 members from 58 countries on six continents. These members include a broad range of OTC derivatives market participants: global, international and regional banks, asset managers, energy and commodities firms, government and supranational entities, insurers and diversified financial institutions, corporations, law firms, exchanges, clearinghouses and other service providers. For more information, please visit: www.isda.org.

[3] 78 Fed. Reg. 68,946.

[4] 78 Fed. Reg. 75,680.

Commission's speculative position limits policy. The rationale contained in the Position Limits NOPR has a direct bearing on the Aggregation NOPR. As stated by the Commission in the Aggregation NOPR, "[t]he aggregation of accounts for purposes of applying position limits represents an integral component that impacts the effectiveness of those limits."[5] In addition to statutory and policy concerns, the Proposed Rules also contain overlapping regulatory definitions. For example, both the Position Limits NOPR and the Aggregation NOPR contain proposed definitions for "eligible entity," a term that is fundamental to the Commission's proposed speculative position aggregation policy. The Position Limits NOPR also contains a proposed definition for "eligible affiliate," a term that also would play an important role in the Commission's speculative position aggregation policy. The Position Limits NOPR also would require designated contract markets and swap execution facilities to have aggregation rules that conform to those proposed in the Aggregation NOPR.[6] As the two Proposed Rules are inextricably linked, we believe it is essential to have sufficient time to review and comment on them together.[7]

Moreover, in order to fully ascertain the impact on their businesses, including compliance costs, related to the proposed rulemakings, our members must apply the Proposed Rules in conjunction with one another. To fully comprehend the impact of the Aggregation NOPR, our members must first fully review, understand and apply the Position Limits NOPR. Both Rule Proposals are complex and understanding their combined impact will require more time beyond January 14, 2014.

In order to have adequate time to review, consider, and comment upon these two Rule Proposals together, we are requesting an extension of the comment period for the Aggregation NOPR to align it with the end of the comment period for the Position Limits NOPR. We do not believe that this modest extension of the Aggregation NOPR's comment period would materially delay the Commission's review of comments and formulation of final rulemakings regarding aggregation and position limits, particularly if the Commission issues final rulemakings on these rules at the same time, as it has done in the past. This additional time for consideration and comment would give the public needed time to present more complete, more thoughtful and integrated comments and suggestions on the Proposed Rules.

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[5] 78 Fed. Reg. at 68,972.

[6] 78 Fed Reg. at 75756-75757

[7] We believe the Commission has recognized this inextricable link between aggregation and position limits in the past as they were initially contained together as part of the same proposal when originally proposed in January 2011 and again were adopted together as final rules in November 2011.

We appreciate your consideration of our comments and requests in this letter. We stand ready to provide any additional information or assistance that the Commission might find useful. Should you have any questions, please do not hesitate to contact Tim Cameron of AMG at 212-313-1389 or Matt Nevins of AMG at 212-313-1176 or Robert Pickel of ISDA at 212-901-6020.

Sincerely,

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cc: Hon. Gary Gensler, Chairman, Commodity Futures Trading Commission
Hon. Bart Chilton, Commissioner, Commodity Futures Trading Commission
Hon. Scott O'Malia, Commissioner, Commodity Futures Trading Commission
Hon. Mark Wetjen, Commissioner, Commodity Futures Trading Commission
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Invested in America

| asset management group

February 10, 2014
Melissa Jurgens
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington DC 20581

Re: ***Notice of Proposed Rulemaking – Aggregation of Positions (RIN 3038-AD82)***

The Asset Management Group ("AMG")[1] of the Securities Industry and Financial Markets Association ("SIFMA") appreciates the opportunity to provide the Commodity Futures Trading Commission (the "Commission") with comments regarding the "Aggregation of Positions" proposed rulemaking ("2013 Aggregation NPRM").[2] We believe that the Commission has made some positive steps in this 2013 Aggregation NPRM, but we have some significant concerns with respect to certain aspects of the proposal, in the following areas in particular:

- ***Owned Entity Aggregation.*** The Commission should not adopt the owned entity aggregation as proposed. Requiring passive investors, which include, without limitation, registered and private commodity pools and other investment vehicles, pension funds and other institutional clients of asset managers, that have no control over, or even knowledge of, the specific commodity derivatives trading activities of owned entities they have invested in to aggregate the positions of such entities would impose significant costs that would unnecessarily diminish their ability to provide valuable capital investment and generate returns for their beneficiaries and participants, exceeds the scope of the Commission's position aggregation authority under the Commodity Exchange Act ("CEA"), and is an unwarranted departure from the Commission's historical aggregation approach. The proposed exemptions from this owned entity aggregation requirement under proposed rules 150.4(b)(2) (10 to 50% ownership) and (b)(3) (above 50% ownership) do not sufficiently address the flaws of the proposed approach to aggregating owned entity positions in the passive investment ownership context.

[1] The AMG's members represent U.S. asset management firms whose combined assets under management exceed $20 trillion. The clients of AMG member firms include, among others, registered investment companies, ERISA plans, and state and local government pension funds, many of whom invest in commodity futures, options, and swaps as part of their respective investment strategies.

[2] 78 Fed. Reg. 68,946 (Nov. 15, 2013).

- ***Investment in Accounts or Pools with "Substantially Identical Trading Strategies."*** The Commission should not adopt the aggregation requirement in proposed 150.4(a)(2) for investments in funds that follow "substantially identical trading strategies" regardless of common trading control, significant ownership, or even knowledge of the relevant investments. This proposal is vague and lacks sufficient statutory, policy, and cost-benefit rationale.

- ***Passive Investors in Commission Regulation 4.13 Exempt Pool Aggregation Requirement.*** We recommend that the Commission amend 150.4(b)(1)(iii) to only require passive investors to aggregate positions of a Commission regulation 4.13 exempt pool based on a 25% or more ownership interest when "the operator of which is exempt from registration *under §§ 4.13(a)(1) or (a)(2)*" in order for this requirement to apply to its intended targets.

- ***Independent Account Controller Exemption.*** We recommend that the Commission extend "independent account controller" eligibility to registered commodity pool operators ("CPOs"), exempt CPOs, and exempt and excluded commodity trading advisors ("CTAs"). We also question the utility of the burdensome requirement on asset managers to submit notice filings to claim the independent account controller exemption.

1. Owned Entity Aggregation

Consistent with current 17 CFR 150.4(a), under proposed 150.4(a)(1), a person would be required to aggregate "positions in accounts" in which the person "directly or indirectly" has more than a 10% ownership interest. The Commission further proposes to interpret "accounts or positions" to include "accounts or positions" of third party[3] owned entities.[4] The Commission interprets ownership of another entity, standing alone, as providing a separate and distinct basis to require aggregation of the positions owned by the owned entity, regardless of actual control of such trading accounts.[5] That is, the Commission interprets the "ownership prong" of CEA section 4a(a)(1) to apply to accounts owned by owned entities if a person has an ownership interest greater than 10% in that owned entity (and otherwise does not have trading control or have a direct ownership interest in the owned entity accounts themselves).[6]

[3] We use the term "third party" to refer to any person that is separate from another person. A person can have relationships with many types of third parties, e.g., an owned entity, an entity it does not have an ownership interest in but whose trading it controls, etc.

[4] *See* proposed 150.4(b)(2) (providing for an exemption from aggregation requirements for positions in accounts of an owned entity when the ownership interest in the owned entity is between 10 and 50% of total equity). *See also* 78 Fed. Reg. at 68,959.

[5] *Id.* citing 77 Fed. Reg. at 31,773.

[6] *Id.* ("The Commission continues to believe, as stated in the Part 151 Aggregation Proposal, that an equity or ownership interest above 50% constitutes a majority ownership or equity interest of the owned entity and is so significant as to justify aggregation under the ownership prong of Section 4a(a)(1) of the CEA.")

For the reasons set forth below, we recommend that the Commission reconsider its proposed owned entity aggregation rules. We present our specific recommendations in section 1.3 below.

1.1. Requiring passive investors that have no control over, or even knowledge of, the specific commodity derivatives trading activities of owned entities to aggregate the positions of such entities will be unduly costly.

While asset management companies would not generally need to aggregate customer positions managed by independent account controllers under proposed 150.4(b)(5)'s independent account controller ("IAC") exemption, individual IAC or non-IAC asset managers often invest customer assets (either directly or through investment vehicles) in entities that trade in commodity derivatives. Under the Commission's proposed 150.4(a), 10% or more ownership in a trading account may be sufficient to warrant aggregation. In this case, under the Commission's interpretation of the term "account,"[7] a purely passive holder of equity securities would be required to aggregate the positions of all entities of which it has beneficial equity ownership of 10% or more, unless it perfects an exemption to owned entity aggregation (most pertinently under proposed 150.4(b)(2) or (b)(3)). An arbitrary owned entity aggregation threshold at 10% ownership is vastly over-inclusive even if it is used as indicia of corporate control;[8] the Commission itself points out that corporate "control" is imputed at 50% or more ownership for the purpose of pre-merger notifications to federal regulators under the Hart–Scott–Rodino Antitrust Improvements Act.[9]

Passive investors of the type managed by AMG members do not have control over owned entities by virtue of their *passive* ownership interest in a legal entity. As such, they would typically only have minimal knowledge of these owned entities' trading positions and decisions.[10] The 2013 Aggregation NPRM would create a new standard of care for passive investors: they would have to determine whether and to what extent the owned entity (and all of its owned entity affiliates) trade in commodity derivatives and if so, act to perfect an exemption. If no exemption is available, then the passive investor would have to obtain reliable commodity

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[7] We believe this reading would constitute an unexplained change from Commission administrative precedent. *See* section 1.4 below.

[8] As discussed below in section 1.7, the appropriate control standard under Commission position limits rules relates to trading control, not corporate control.

[9] 78 Fed. Reg. at 68,958, *citing* 16 CFR 801.1(b).

[10] Under some circumstances, when a passive investor (for example an Employee Retirement Income Security Act ("ERISA") plan) makes an investment in an entity, the investor's fiduciary duties (for example, as created under ERISA) could very well entail making prudent inquiries into the trading activities and investments of the owned entity. *See Harley v. Minnesota, Mining and Manufacturing Co*., 898 F. Supp. 2d 898, 906 (D. Minn. 1999) ('[A] fiduciary is required to undertake an independent investigation into the merits of an investment and to use appropriate, prudent methods in conducting the investigation."), *aff'd,* 284 F.3d 901 (8th Cir. 2002), *cert. denied*, 537 U.S. 1106 (2003); 29 CFR § 2550.404a-1(b)(2) (providing that an investment fiduciary, when evaluating an investment, must take into consideration the risk of loss associated with the investment).

derivatives position information from the entities in which it invests and is required to aggregate in order to ensure compliance with speculative position limits. In addition, these passive investors would have to develop, often from scratch, costly position monitoring infrastructure and hire or train staff to apply that infrastructure to the derivatives positions of their investments in order to ensure compliance with position limits. These costs to passive investors would deter investment in businesses that own commodity positions and are not offset by any commensurate benefit, especially in terms of reduced likelihood of excessive speculation or manipulation.

1.2. The proposed owned entity aggregation exemptions provide inadequate relief for passive investors and do nothing to further the goals Congress directed the Commission to achieve in promulgating position limits.

The Commission proposes two exemptions to the proposed general rule that requires a person to aggregate accounts owned by a third-party entity where such person has a greater than 10% ownership in the owned entity:

1. Under proposed 150.4(b)(2), the Commission proposes an aggregation exemption for ownership interests of up to 50% of an entity's equity under certain conditions. The owner and the owned entity ("Related Entities") must not have knowledge of one another's trading decisions and have in place protections to ensure independence, including: (1) enforced written procedures to prevent sharing of trading information; (2) physical separations; (3) separately developed and independent trading systems; (4) no sharing of employees that control trading decisions; and (5) no sharing of risk management systems that permit sharing of trading information or strategies before a trade is made. This exemption is effective upon submission of a notice filing under proposed 150.4(c)(1).

2. Under proposed 150.4(b)(3), the Commission proposes an aggregation exemption for ownership interests above 50% ownership under certain conditions. These conditions include all of those described above for ownership interests at and below 50% ownership, plus: (1) certification that the Related Entities' financial results are not consolidated in a financial statement pursuant to relevant accounting rules; (2) each director for the owned entity certifies that (a) all of the owned entity's positions are bona fide hedging positions, or (b) the owned entity's positions do not exceed 20% of any position limit. This exemption must be approved by the Commission or staff operating under delegated authority in order to become effective under proposed 150.4(c)(2).

These two exemptions would provide inadequate relief for passive investors and would do nothing to further the goals Congress directed the Commission to achieve in promulgating position limits.

First, while a move in the right direction, the proposed 150.4(b)(2) exemption from aggregation for ownership interests of up to 50% in the owned entity does not extend to all ownership interests and would require a burdensome notice filing in all investment circumstances, regardless of the absence of common trading control, for no apparent benefit. By

contrast, passive investors in a pool that are not affiliated with the pool operator under proposed 150.4(b)(1) would not be required to submit a notice filing to disaggregate the positions of pools in which they have invested, regardless of their ownership interest in the pool. Again, the 2013 Aggregation NPRM provides no reason why passive investors in owned entities should not have at least the same degree of deference.

Second, the proposed application-based exemption from aggregation in 150.4(b)(3) for ownership interests in excess of 50% is, as a practical matter, unworkable. Passive investors cannot plan their investment and compliance programs around a disaggregation application filing that depends on Commission approval which, even if granted, may take weeks or months to issue, while their managers may need to make immediate investment decisions.

Moreover, the conditions imposed on the proposed 150.4(b)(3) exemption seriously constrain its utility. This is particularly true of the condition prohibiting consolidation of financial results. The fact that an investor consolidates the financial results of the firms in which it invests is not indicative of trading control; earning returns on an investment is the main reason an investor invests. In addition, the requirement that the owned entity's positions not exceed 20% of any position limit effectively subjects owned entities to lower position limits.[11] The 2013 Aggregation NPRM makes no findings that this restriction furthers any of the goals Congress directed the Commission to achieve in promulgating position limits rules under CEA sections 4a(a)(2)(C) and 4a(a)(3)(B).

1.3. The Commission should reconsider its owned entity aggregation requirements.

For reasons stated in more detail in section 1.4 below, we believe the Commission's proposed owned entity aggregation requirements are legally flawed and based on an erroneous interpretation of the CEA and applicable administrative precedent. We recommend, therefore, that the Commission re-examine the 2013 Aggregation NPRM and substantially amend the proposed 150.4(b)(2) and (3) exemptions to achieve a more appropriate balance among the six statutory factors that the CEA requires the Commission to address when promulgating any position limit rules,[12] by:

[11] The alternative requirement that all of the owned entity's positions be bona fide hedging positions is not an independent condition. CEA section 4a(c)(1) prohibits the Commission from restricting the bona fide hedging positions of any trader: "No rule, regulation, or order issued under subsection (a) of this section shall apply to transactions or positions which are shown to be bona fide hedging transactions[.]" CEA section 4a(c)(1). Therefore, the limitation that an owned entity's positions be limited entirely to bona fide hedging positions is simply a sub-set of the requirement that would restrict speculative positions up to 20% of any limit.

[12] These factors include the "goals" stated in CEA section 4a(a)(2)(C), i.e., "striv[ing] to ensure" that (Factor 1) "trading on foreign boards of trade in the same commodity will be subject to comparable limits" and (Factor 2) "that any limits to be imposed by the Commission will not cause price discovery in the commodity to shift to trading [to FBOTs]." They also include the four additional factors that CEA section 4a(a)(3)(B) directs the Commission to balance when exercising its CEA section 4a(a)(2) authority: (1) (Factor 3) to diminish, eliminate, or prevent excessive speculation causing sudden or unreasonable fluctuations or unwarranted changes in price; (2) (Factor 4) to deter and prevent market manipulation, squeezes, and corners; (3) (Factor 5) to ensure sufficient market liquidity for bona fide hedgers; and (4) (Factor 6) to ensure that the price discovery function of the underlying market is not disrupted.

1. Extending the relief provided to passive investors in commodity pools under current 150.4(c) and proposed 150.4(b)(1) to passive investors in owned entities that do not have actual trading control of the owned entity's derivatives trading; and

2. Extending the owned entity exemption at proposed 150.4(b)(2) to include all third party ownership interests (greater than 50%) that do not involve actual common trading control.

In addition, we recommend three additional, non-exclusive changes that would reduce the cost to comply without forgoing meaningful regulatory benefit under the six statutory factors referenced above:

Filing requirements: The Commission should only require a 150.4(c)(1) notice filing when there is majority ownership in addition to indicia of trading control, e.g., a common business purpose relating to derivatives trading or the commercial use of commodities. The Commission's proposed 150.4(c)(2) application procedure should be omitted altogether or reserved for instances where there is majority ownership in addition to a trading control. In any event, a passive investor that holds an equity investment of any amount in an operating company that it has no trading control over should not be required to make any type of filing. If the Commission insists on a filing requirement for passive investors, then it should allow for a simplified, generic omnibus filing that would provide the Commission with notice that a passive investor intends to use the exemption on a going-forward basis consistent with the terms of the exemption for its passive equity investments.

Pro rata attribution of positions: The Commission should allow for the *pro rata* attribution of positions based on ownership interest. *Pro rata* allocation of positions would be less costly for passive investors because it would provide them some proportionate degree of protection if their owned entity exceeds a position limit. For example, for a passive investor with a 15% ownership interest in an owned entity that exceeds a position limit, an allocation of 15% or even 25% of that owned entity's positions would reduce the risk of an inadvertent position limits overage. Accordingly, we recommend *pro rata* allocation of ownership interests within set bands of ownership percentages.

Quarterly measurement: The costs of complying with the Commission's proposed aggregation rules would also be reduced if the Commission provided a safe harbor to passive investors to measure ownership interests on a predetermined basis, such as on quarterly dates. Permitting passive investors to measure ownership interests on a fixed and workable schedule will not undermine the Commission's position limits regime. This approach would mitigate our members' concerns about disruptions to their clients' investments that could otherwise result from frequent changes in ownership interests.

These recommendations would present substantially reduced costs for AMG members and their clients yet would still ensure at least the same degree of efficacy of the Commission's position limits regime under the goals provided by Congress in CEA sections 4a(a)(2)(C) and 4a(a)(3)(B) by providing passive investors with legal certainty that would promote liquidity in

commodity derivatives. In fact, the Commission's proposal would increase the potential for coordinated manipulative trading activity because it mandates common trading control where none currently exists.

1.4. Requiring passive investors that have no control over, or knowledge of, the specific commodity derivatives trading activities of owned entities they have invested in to aggregate the positions of such entities has not been justified.

1.4.1. Requiring passive investors that have no control over, or knowledge of, the specific commodity derivatives trading activities of owned entities they have invested in to aggregate the positions of such entities exceeds the scope of the Commission's position aggregation authority under the CEA.

The 2013 Aggregation NPRM states its basis for requiring the aggregation of owned entity positions regardless of the existence of common trading control as follows (emphasis added):

> In light of the language in section 4a, its legislative history, subsequent regulatory developments, and the Commission's historical practices in this regard, the Commission continues to believe that section 4a requires aggregation on the basis of *either ownership or control of an entity*.[13]

The relevant portion of CEA section 4a(a)(1) provides (emphasis added):

> [T]he positions held and trading done by *any persons directly or indirectly controlled by such person* shall be included with the positions held and trading done by such person; and further, such limits upon positions and trading shall apply to positions held by, and trading done by, two or more persons acting pursuant to an expressed or implied agreement or understanding, the same as if the positions were held by, or the trading were done by, a single person.

CEA section 4a(a)(1), by its terms, requires aggregation of positions held and trading done by third parties only when the other person is "*directly or indirectly controlled*."[14] This is not a situation where the CEA is silent about aggregating the positions of third parties (including owned entities) so that the Commission might fill the gap by inferring that the "ownership prong" applies to positions held by an owned third party; rather, the statute specifically addresses the conditions under which a third party's positions are to be aggregated, i.e., when the positions

[13] 78 Fed. Reg. at 68,956.

[14] In the first critical clause quoted above, the phrase "any person" refers to a third party, whereas the phrase "such person" refers to the principal person subject to this statutory aggregation provision. Thus, re-phrasing the clause slightly for purposes of clarification, the positions held and trading done by a third party (e.g., the company in which an investor invests) directly or indirectly controlled by a person (e.g., the investor) shall be included with the positions held and trading done by that person (e.g., the investor). By contrast, the "ownership prong" that appears immediately after this first clause applies only to directly held positions ("positions held and trading done by such person," e.g., the investor).

held and trading done by the third party are "directly or indirectly controlled." With respect to positions held and trading done by third parties, CEA section 4a(a)(1) imposes a constraint on the Commission's authority to require aggregation. CEA section 4a(a)(1) provides that the aggregation of positions held and trading done by third parties is to occur <u>only</u> when the positions held and trading done by the third party are "directly or indirectly controlled" ("Third Party Aggregation Constraint").

The statutory Third Party Aggregation Constraint is consistent with the legislative history of CEA section 4a. As cited in the Commission's 2012 "Aggregation, Position Limits for Futures and Swaps" proposed rulemaking,[15] a 1968 Senate Report provides that "Section 2 of the bill amends section 4a(1) of the [CEA] to show clearly the authority to impose limits on […] trading done and positions held by *a person controlled by another* shall be considered as done or held by" a person (e.g., the investor).[16]

1.4.2. Requiring passive investors that have no control over, or knowledge of, the specific commodity derivatives trading activities of owned entities they have invested in to aggregate the positions of such entities is an unwarranted departure from the Commission's historical aggregation approach.

The Commission interprets 17 CFR 150.4(b) and proposed Commission regulation 150.4(a) as requiring the aggregation of owned entity positions.[17] The Commission, however, has never promulgated rules (that were not vacated) in which it has interpreted "accounts" to encompass accounts owned by third parties that are commonly owned but not commonly controlled. All of the Commission's pre-2011 position aggregation rulemakings required aggregation on the basis of direct ownership in accounts, not ownership interests in third parties who, in turn, own positions in derivatives trading accounts.

For example, the Commission's 1979 Statement of Aggregation Policy is squarely focused on ownership of accounts, not ownership in entities that own accounts.[18] Its first point stated that "[e]xcept for a limited partner or shareholder in a commodity pool, any person who has a 10% or more financial interest *in an account* will be considered as an account controller" (emphasis added).[19] The 1979 Statement of Aggregation Policy defines "discretionary account" as "a commodity futures trading account for which buying and/or selling orders can be placed or originated, or for which transactions can be effected…"[20]

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[15] 77 Fed. Reg. 31,767 (May 30, 2012).

[16] *Id.* at 31,772 at fn. 80, citing S. Rep No. 947, 90th Cong., 2 Sess. 5 (1968) (emphasis added).

[17] Proposed 150.4(a) ("For the purpose of applying the position limits set forth in § 150.2, unless an exemption set forth in paragraph (b) of this section applies, all positions in accounts for which any person, by power of attorney or otherwise, directly or indirectly controls trading or holds a 10% or greater ownership or equity interest, must be aggregated with the positions held and trading done by such person.").

[18] Statement of Policy on Aggregation of Accounts and Adoption of Related Reporting Rules, 44 Fed. Reg. 33,839 (Jun. 13, 1979).

[19] *Id.* at 33,845.

[20] *Id.*

The 2013 Aggregation NPRM presents the following quote from a position limits rulemaking from 1999 in an attempt to support its interpretation that CEA section 4a(a)(1)'s "ownership prong" includes ownership of third parties' accounts: "the Commission . . . interprets the 'held or controlled' criteria [of CEA section 4a] as applying separately to ownership of positions or to control of trading decisions."[21] However, this quote does not refer to accounts of owned entities. This is not surprising as, again, this 1999 rulemaking was squarely focused on the aggregation of directly owned accounts – and not of accounts owned by an owned third party. For example, the 1999 rulemaking provided that when a person "holds or has a financial interest in or controls more than one account, all such accounts shall be considered by the futures commission merchant, clearing member or foreign broker as a single account…"[22] Thus, neither the quote nor the rulemaking from 1999 support the interpretation in the 2013 Aggregation NPRM.

Contrary to the assertion of the 2013 Aggregation NPRM, the Commission has in fact clearly distinguished between ownership of accounts, on the one hand, and ownership in third party entities that themselves own accounts, on the other. In the context of its CFTC Form 40 rules at 17 CFR 18.04(a)(8), the Commission requires the reporting of information relating to "persons… who have a financial interest of 10% or more in the [Form 40] reporting trader *or* the accounts of the reporting trader" (emphasis added). If financial interests in "accounts" encompassed financial interests in accounts of other persons, then the Commission would have had no need to separately articulate the requirement to report financial interests in the accounts of a reporting trader and the requirement to report financial interests in the reporting trader itself.

The Commission's historical definition of "account" in the position aggregation context is consistent with other Commission regulations that also similarly define the term "account." For example, 17 CFR 39.2 defines "customer account" as meaning "a clearing member account held on behalf of customers, as that term is defined in this section, and which is subject to section 4d(a) or section 4d(f) of the [CEA]" and "house account" as meaning "a clearing member account which is not subject to section 4d(a) or 4d(f) of the [CEA]." 17 CFR 1.3(vv) defines "futures account" to mean an "account that is maintained in accordance with the segregation requirements of sections 4d(a) and 4d(b) of the [CEA] and the rules thereunder." None of these regulations define an "account" as encompassing accounts of owned entities.

The one exception is the Commission's definition of "proprietary account" in 17 CFR 1.3(y),[23] which is defined explicitly to include accounts held by "business affiliates."[24] This term

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[21] 78 Fed. Reg. at 68,956, *quoting* Revision of Federal Speculative Position Limits and Associated Rules, 64 Fed. Reg. 24,038, 24,044 (May 5, 1999).

[22] *Id.* at 24,046.

[23] 17 CFR 1.3(y) "*Proprietary account*. This term means a commodity futures, commodity option, or swap trading account carried on the books and records of an individual, a partnership, corporation or other type of association: (1) for one of the following persons, or (2) of which ten percent or more is owned by one of the following persons, or an aggregate of ten percent or more of which is owned by more than one of the following persons:

[...]

is cited as support for the Commission's new interpretation of the term "account" in the position limits context.[25] The term "proprietary account," however, is irrelevant to the position limits context. The term "proprietary account" is used in 17 CFR 155.3, which requires that a futures commission merchant ("FCM") give priority to executing customer orders over orders from any "proprietary account." Moreover, the fact that the term "proprietary account" is explicitly defined to include accounts held by "business affiliates" suggests that in the Commission's regulations, the term "account," standing alone, does not include accounts of owned entities but rather refers only to directly held or controlled trading accounts.

Even the Commission's enforcement history reflects that it has traditionally viewed aggregation of owned entity positions as only being required where there is common derivatives trading control. The import of the Commission's Order settling an administrative enforcement action in September 2010 against Vitol Inc. and one of its affiliates for false statements in connection with NYMEX position aggregation rules (which parallel Commission rules),[26] is that control was a pre-requisite in considering whether Vitol Inc. was required to aggregate the positions of its commonly-owned affiliate.[27] The recitation of facts in the Commission's Order

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> (viii) A business affiliate that, directly or indirectly is controlled by or is under common control with, such individual, partnership, corporation or association: P*rovided*, *however*, That an account owned by any shareholder or member of a cooperative association of producers, within the meaning of section 6a of the [CEA], which association is registered as a futures commission merchant and carries such account on its records, shall be deemed to be an account of a customer and not a proprietary account of such association, unless the shareholder or member is an officer, director or manager of the association."

[24] 17 CFR 1.3(y)(1)(viii).

[25] 78 Fed. Reg. 68,956 citing 17 CFR 1.3(y).

[26] "Ownership of Accounts – Except as set forth in Section E. below, any person holding positions in more than one account, or holding accounts or positions in which the person by power of attorney or otherwise directly or indirectly has a 10% or greater ownership or equity interest, must aggregate all such accounts or positions unless such person is a limited partner, shareholder, member of a limited liability company, beneficiary of a trust or similar type of pool participant in a commodity pool. […]." CME Rule 559.D.2, available at http://www.cmegroup.com/rulebook/CME/I/5/5.pdf. Certain commodities are currently subject only to position limit rules set by designated contract markets ("DCMs"). Aggregation for purposes of DCM-set position limits today is governed by Core Principle 5 "Position Limitations or Accountability" in CEA section 5(d)(5) and subpart F of 17 CFR part 28. CEA section 5(d)(1)(B) provides that DCMs have "reasonable discretion in establishing the manner in which the board of trade complies with the core principles described in this subsection" unless "otherwise determined by the Commission by rule or regulation." Under 17 CFR 38.301, DCMs "must meet the requirements of parts 150 and 151 of this chapter, as applicable." The only Commission regulation that relates to the aggregation of positions for exchange-set position limits (and that was not vacated) is 17 CFR 150.5(g). 17 CFR 150.5(g) provides that DCMs must aggregate on the basis of control and does not prescribe any other standard:

> In determining whether any person has exceeded the limits established under this section, all positions in accounts for which such person by power of attorney or otherwise directly or indirectly controls trading shall be included with the positions held by such person[.]

[27] In the Matter of Vitol Inc. et al., Docket No. 10-17 (CFTC Sept. 14, 2010), available at http:// www.cftc.gov/ucm/groups/public/@lrenforcementactions/documents/legalpleading/enfvitolorder09142010.pdf. In this matter, the Commission found that Vitol Inc. and its affiliate willfully failed to correct NYMEX's misperception of the "true nature of the relationship between" Vitol Inc. and its affiliate and imposed a civil monetary penalty of $6 million.

focused on Vitol Inc.'s failure to disclose information relating to the "flow of trading information between" the affiliated entities and the "limited nature of the barriers to trading information flow between" these presumably commonly owned Vitol affiliates.[28] These facts would have been relevant only if common control were a pre-condition to the application of the position aggregation rules (as it is due to the statutory Third Party Aggregation Constraint). Tellingly, no facts relating to common ownership were included in the Order.[29]

1.4.3. The 2013 Aggregation NPRM uses an inappropriate baseline in considering the costs and benefits of its proposed owned entity aggregation rules.

In its discussion of "Cost-Benefit Considerations," the 2013 Aggregation NPRM states that its proposed owned entity aggregation policy is "more permissive than the 10% [owned entity position aggregation] threshold currently provided."[30] It therefore assumes a cost-benefit baseline that requires aggregation of positions for position limit compliance purposes based solely on ownership, regardless of the existence of common control.

This is an inappropriate baseline for two important reasons. First, as described above, neither the Commission nor DCMs (which currently are the sole administrators of position limits for all but nine agricultural commodities, including 19 of the 28 "referenced contracts"), currently require the aggregation of owned entity positions regardless of the existence of common control. Therefore, the Commission's proposal is more restrictive, not "more permissive" than (and, indeed, a dramatic departure from) the existing position aggregation regime. Second, speculative positions outside of the spot month have not been subject to position limits in 19 of the 28 "referenced contract" markets the Commission proposes to subject to position limits under an accompanying release.[31] Aggregating non-spot-month positions of entities in which passive investors make investments presents considerable new challenges, which have not been adequately considered by the 2013 Aggregation NPRM.

1.4.4. "Control" in the context of position aggregation requirements means actual control of derivatives trading, not of anything else, and therefore the owned entity aggregation requirements cannot be based on a theory of corporate control.

[28] *Id.*

[29] *See also* Order Instituting Proceedings Pursuant to Sections 6(c) and 6(d) of the Commodity Exchange Act, as Amended, Making Findings and Imposing Remedial Sanctions, at 4, http://www.cftc.gov/ucm/groups/public/@lrenforcementactions/documents/legalpleading/enfcitigroupcgmlorder092112.pdf (Sept. 21, 2012) (finding that Citigroup was liable for the position limits violation of its subsidiary Citigroup Global Markets not on the basis of owned entity aggregation requirements under 17 CFR 150.4(b), but rather on the basis of an agency theory (CEA section 2(a)(1)(B) and 17 CFR 1.2).

[30] 78 Fed. Reg. at 68,968.

[31] 78 Fed. Reg. at 75,826. AMG is commenting separately on this proposal, including proposed 150.5(a)(5) providing that aggregation requirements of exchanges must "conform to" those of the Commission under proposed 150.4.

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As noted above, the 2013 Aggregation NPRM bases its proposed owned entity aggregation rules solely on CEA section 4a(a)(1)'s "ownership prong." The 2013 Aggregation NPRM suggests in defense of the 50% ownership aggregation exemption threshold in proposed 150.4(b)(2) that an ownership interest of greater than 50% "is indicative of control" and therefore warrants aggregation of an owned entity's positions even in the absence of any actual trading control. This conclusion appears to be based on conflated notions of corporate control in other contexts with trading control in the position limits context. The Commission cites a 50% equity ownership threshold used by the Federal Trade Commission and Department of Justice as "reflect[ing] a general understanding that ownership at this level poses substantial potential for direct or indirect control over an owned entity."[32] This threshold is used by these other government agencies to identify potential instances of common corporate control for the purpose of anti-trust filing requirements, not of common derivatives trading control.[33] Speculative position limits aggregation requirements are based on whether ownership is indicative of derivatives *trading control*, not corporate control.

The Commission has traditionally interpreted "control" in CEA section 4a(a)(1) and its predecessors as control of trading, not of corporate control or any other concept of control. For example, the Commission's current IAC exemption to position aggregation requirements focuses on the controller's independent control of trading decisions and lack of knowledge of the trading decisions of any other IAC.[34] Indeed, the 2013 Aggregation NPRM appropriately models the conditions for the owned entity aggregation exemption in proposed 150.4(b)(2) on the conditions for the IAC exemption, i.e. factors that demonstrate independent trading control. Similarly, the Commission's definition of "controlled account" at 17 CFR 1.3(j) means an account for which a person "actually directs trading."[35] Perhaps most important of all, the terms of the Commission's proposal appear to focus on trading control, not corporate control. The Commission's proposed general aggregation rule (150.4) requires aggregation when a person "directly or indirectly controls *trading*."

Thus, even if the Commission were to abandon the ownership theory relied upon in the 2013 Aggregation NPRM for a control theory instead, the result is the same: the proposal provides no basis for the Commission to depart from its historical view that position aggregation is required only where actual common trading control exists, e.g., when an investor controls the derivatives trading that occurs in a an owned entity's accounts.[36]

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[32] 78 Fed. Reg. at 68,958, *citing* 16 CFR 801.1(b).

[33] *See* 16 CFR 802.2.

[34] 17 CFR 150.1(e).

[35] *See also* CFTC Form 102, available at http:// www.cftc.gov/ucm/groups/public/@forms/documents/file/cftcform102.pdf (prompting FCMs and others to identify "controlled accounts" of the same advisor exceeding "special account" activity thresholds).

[36] 78 Fed. Reg. at 68,958.

2. Passive Investment in Commission Regulation 4.13 Exempt Commodity Pools

2.1. The passive 17 CFR 4.13 exempt pool investor aggregation requirement should be omitted.

The 2013 NPRM proposes to require aggregation of positions in a 17 CFR 4.13 pool when a person holds a greater than 25% ownership interest in the pool under proposed 150.4(b)(1)(iii). This proposed rule is identical to current Commission rule 150.4(c)(2)(iii). The rationale for the current rule was that when there are "10 or fewer limited partners or when a limited partner has an ownership interest of 25% or greater, the limited partner" should be required to aggregate the positions of the pool.[37] The Commission was particularly concerned about single-investor pools when it adopted this requirement.[38] The only sub-paragraphs of current 17 CFR 4.13 that encompass the intended targets of this provision are sub-paragraphs (a)(1) and (a)(2). We therefore recommend that the Commission amend 150.4(b)(1)(iii) to apply to pools "the operator of which is exempt from registration *under §§ 4.13(a)(1) or (a)(2)*" in order for this requirement to apply to its intended targets.

3. Investment in Accounts or Pools with "Substantially Identical Trading Strategies"

Proposed 150.4(a)(2) provides that holding or controlling trading in more than one account or pool (collectively "funds") with "substantially identical trading strategies" requires aggregation ("SITS Rule"). This requirement would apply notwithstanding any other applicable aggregation exemption. In other words, the proposed SITS Rule would apply regardless of common control, significant ownership, or even knowledge of the relevant investments in funds with "substantially identical trading strategies."

The proposed SITS Rule should be omitted from any final rulemaking because it lacks sufficient rationale and is unworkable in practice, as discussed below. In the alternative, proposed 150.4(a)(2) should be amended to apply to "any person that, by power of attorney or otherwise, ~~holds or~~ directly controls the trading of positions" in a SITS account or pool.

3.1. The proposed SITS Rule lacks rationale.

The Commission does not provide a statutory or policy rationale for the proposed SITS Rule in the 2013 Aggregation NPRM or its 2012 predecessor.[39] The Commission's 2011 "Position Limits for Futures and Swaps" final rulemaking did contain a short rationale for a similar requirement for investments in funds with "identical trading strategies."[40] This provision, the Commission stated, was "intended to prevent circumvention of the aggregation requirements.

[37] 64 Fed. Reg. at 24,044.

[38] *Id.*

[39] There are, however, four mentions of the "identical trading strategies" rule in footnotes to the 2012 proposal. *See* e.g., 77 Fed. Reg. at 31,769 at fn. 14.

[40] *See* vacated 151.4(d).

In [the] absence of such [an] aggregation requirement, a trader can, for example, acquire a large long-only position in a given commodity through positions in multiple pools, without exceeding the applicable position limits."[41] However, the 2011 rulemaking provided no historical example of any such circumvention.[42]

Finally, the 2013 Aggregation NPRM fails altogether to consider the costs and benefits of the aggregation requirement for investments in funds that follow "substantially identical trading strategies," despite the very real costs that such a requirement would have on investors.

3.2. The proposed SITS Rule is unworkable in practice.

As a consequence of the proposed SITS Rule, a $10,000 investor in two $1 billion commodity index mutual funds using the same index may have to aggregate the positions in those two $1 billion mutual funds because they follow "substantially identical trading strategies." To provide another example, under the proposed SITS Rule, a $10,000 investor in a fund-of-funds that, in turn, invests $10,000 in two $1 billion commodity index funds that follow "substantially identical trading strategies" would have to aggregate the positions in those two $1 billion funds – even if the investor did not know how the fund-of-funds manager allocated the investor's money. (In contrast, under proposed 150.4(b)(1)'s exemption for investors in commodity pools, it appears that if an investor made a $500 million investment in a single $1 billion commodity index pool, it would be exempt from speculative position limits altogether).

To comply with the aggregation requirement of the proposed SITS Rule, the investor in the foregoing scenarios would not only have to determine how his or her funds are being invested, but also the trading strategies of all of the relevant funds and whether they meet the undefined test of being "substantially identical." Then, he or she would need a data feed to determine the size of the commodity derivatives positions in each fund determined to be using a "substantially identical trading strategy." Such a requirement would simply be unworkable in most cases (depending on, among other things, the size of the investment, the size of the funds with "substantially identical trading strategies" that the investor's money has been invested in, and the investor's other countable commodity derivatives positions). Even if it could be done (the practical impediments described above aside, there would also be significant and costly legal and operational obstacles to overcome), to implement such a compliance program to prevent inadvertent violations of speculative position limits due to the aggregation requirement of the proposed SITS Rule, would cost many times the investor's $10,000 investments.

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[41] 76 Fed. Reg. at 71,654.

[42] The 2011 rulemaking was not very clear when it adopted an aggregation requirement for investments in accounts or pools with "identical trading strategies." Now, the 2013 Aggregation NPRM provides no guidance as to the meaning of "substantially identical trading strategies," nor does it explain how the concern about circumvention has changed from 2011 to 2013 that would explain the difference between "identical" and "substantially identical."

4. Independent Account Controller Exemption

We commend the Commission's inclusion of an IAC exemption that allows asset management companies to disaggregate the positions of customer accounts controlled by an IAC. We also commend the Commission for proposing to allow managers of employee benefit plans in proposed 150.4(b)(5) to qualify as IACs. We do have concerns, however, with two aspects of the proposed IAC exemption, described below.

4.1. The definition of IAC[43] should not be limited based upon CPO or CTA status.

The status of entities as registered, exempt or excluded CPOs or CTAs has nothing to do with the purpose behind the IAC: to provide for a safe harbor from aggregation requirements where there is no shared ownership or control between a parent advisor and sub-advisors. The Commission has not articulated a reason why IAC status should be limited to certain registrants on the one hand and certain exempt or excluded entities on the other. All pool operators and trading advisors should be able to avail themselves of the IAC exemption, irrespective of their status as registered, exempt or excluded.

4.2. The proposed IAC notice filing should not be required.

We question the utility of requiring asset managers to submit notice filings complying with proposed 150.4(c)(1) to claim the proposed 150.4(b)(5) IAC exemption. Under the Commission's current IAC exemption (17 CFR 150.3(e)), no such filing is required. The new proposed filing is unduly burdensome, particularly given the fact that we are aware of no abuses of the existing IAC exemption. In lieu of a notice filing, the Commission should consider a requirement to keep records on the eligible entity's and IAC's compliance with the conditions of the IAC exemption. If, however, the Commission requires a filing, it should allow for a simplified generic, omnibus filing that would provide the Commission notice that an eligible entity intends to use the exemption on a going-forward basis consistent with the terms of the exemption.

5. Summary

For the reasons stated above, we recommend that the Commission make the following changes in any final rulemaking adopting the 2013 Aggregation NPRM:

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[43] Proposed 150.1 defines "independent account controller" to mean a person (1) who specifically is authorized by an eligible entity, independently to control trading decisions on behalf of, but without the day-to-day direction of, the eligible entity; (2) over whose trading the eligible entity maintains only such minimum control as is consistent with its fiduciary responsibilities for managed positions and accounts to fulfill its duty to supervise diligently the trading done on its behalf or as is consistent with such other legal rights or obligations that may be incumbent upon the eligible entry to fulfill; (3) who trades independently of the eligible entity and of any other IAC trading for the eligible entity; (4) who has no knowledge of trading decisions by any other IAC; and (5) who is (i) registered as an FCM, an introducing broker, a CTA, or an associated person of any such registrant, or (ii) a general partner, managing member or manager of a commodity pool the operator of which is excluded from registration under Rule 4.5 or 4.13.

- The Commission should not adopt the proposed owned entity aggregation as proposed. Instead, the rules should be amended as discussed above in order to address the impact on passive investors that have no control over, or even knowledge of, the specific commodity derivatives trading activities of owned entities in which they have invested.

- The Commission should amend 150.4(b)(1)(iii) to only require passive investors to aggregate positions of a Commission regulation 4.13 exempt pool based on a 25% or more ownership interest when "the operator of which is exempt from registration *under §§ 4.13(a)(1) or (a)(2)*."

- The Commission should omit the requirement to aggregate investments in funds that follow "substantially identical trading strategies" from any final rulemaking.

- The Commission should expand the scope of entities eligible to become IACs, so no distinction is made based upon CPO or CTA registration, exemption or exclusion status. In addition, the IAC notice filing requirements should be eliminated.

*   *   *

We appreciate your consideration of our comments. We stand ready to provide any additional information or assistance that the Commission might find useful. Should you have any questions, please do not hesitate to contact Matt Nevins at 212-313-1176 or Michael Loesch at 202-662-4552.

Sincerely,

Timothy W. Cameron, Esq.
Managing Director, Asset Management Group
Securities Industry and Financial Markets Association

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MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK

February 9, 2014

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

Melissa D. Jurgens
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: RIN 3038-AD99, Position Limits for Derivatives

Dear Ms. Jurgens:

Managed Funds Association[1] ("**MFA**") appreciates the opportunity to provide comments to the Commodity Futures Trading Commission (the "**Commission**" or "**CFTC**") on its notice of proposed rulemaking to modify the Commission's position limits rules (the "**NPRM**").[2] MFA has carefully reviewed the NPRM and is offering its comments to assist the Commission in its efforts to draft final rules that balance the Commission's objectives with legitimate industry concerns.

MFA members rely on fair, competitive and transparent markets that respond to fundamental market factors to conduct their businesses. MFA members play a vital role in the derivatives industry by assuming price risk from commercial participants (hedgers) on the long and short sides of the market, and providing the liquidity that facilitates price discovery and risk transfer for businesses around the world. Our members participate in the marketplace when they trade futures and swaps and when they invest in other financial entities or institutions and

[1] Managed Funds Association (MFA) represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry's contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, the Americas, Australia and many other regions where MFA members are market participants.

[2] Position Limits for Derivatives, 78 Fed. Reg. 75,680 (proposed Dec. 12, 2013).

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operating companies.[3] Accordingly, MFA members are interested in the impact the Commission's new position limits regime will have on them and their investors.

The Commission has previously published two notices of proposed rulemaking related to the imposition of position limits on derivatives. The first such notice was issued in response to energy price volatility and was subsequently withdrawn (the "**January 2010 Notice**").[4] The second notice was issued, and the rules were adopted, in 2011, but ultimately the rules were vacated by the D.C. District Court (the "**Vacated Rules**").[5] MFA commented on both rulemakings. In MFA's comment letter on the January 2010 Notice, we expressed several broad concerns about the proposed position limits, including that (i) research and experience demonstrate that position limits have not reduced price volatility or prevented market manipulation, and it was not clear how the proposed federal limits would achieve their intended purpose with respect to energy markets; (ii) proposed federal limits likely will result in decreased market liquidity, which in turn would impair the ability of commercial market participants to hedge against rising prices; (iii) restricting trading on U.S. futures markets may drive trading overseas, reducing the competitiveness of U.S. markets; (iv) the costs of the proposed federal limits far outweighed the benefits; (v) the Commission underestimated the number of affected parties, the costs to the market of compliance with the proposed rules and the potential unintended consequences; and (vi) the Commission should have considered the availability of alternative approaches.[6]

MFA's comment letter on the Vacated Rules reiterated our concerns articulated in our comment letter on the January 2010 Notice, and we further commented on the adverse effects of basing position limits on a percentage of deliverable supply, including the unnecessary

[3] For example, some of MFA's members invest in non-financial operating companies whose businesses involve the production, refining, merchandising or processing of energy and entities engaged in the development of energy market infrastructure (such as production, transportation or storage of energy), and thus have an interest in enabling such entities to access liquid price discovery and risk-shifting markets. MFA's members also may invest in financial institutions, whose businesses may involve the use of the futures markets for risk management purposes.

[4] Federal Speculative Position Limits for Referenced Energy Contracts and Associated Regulations, 75 Fed. Reg. 4,144 (proposed Jan. 26, 2010), withdrawn 75 Fed. Reg. 50,950 (Aug. 18, 2010).

[5] Position Limits for Derivatives, 76 Fed. Reg. 4,752 (proposed Jan. 26, 2011); Position Limits for Futures and Swaps, 76 Fed. Reg. 71,626 (adopted Nov. 18, 2011); vacated by *International Swaps and Derivatives Association v. U.S. Commodity Futures Trading Commission*, 887 F.Supp.2d 259 (D.D.C. 2012).

[6] Letter from Richard H. Baker, President and CEO, Managed Funds Association, to David A. Stawick, Secretary, Commodity Futures Trading Commission (Apr. 26, 2010), *available at* http://www.managedfunds.org/downloads/MFA%20CFTC%20energy%20spec%20limits.4.26.10.pdf [hereinafter "MFA 2010 Comment Letter"]. In the MFA 2010 Comment Letter, we also provided a number of specific comments on the January 2010 Notice, including (a) the negative effects of the proposed "crowding out" provision in the spot month; (b) the need to preserve the existing disaggregation relief for independently controlled accounts; (c) the need for greater transparency in the calculation of open interest and deliverable supply; (d) flaws in the methodology for annual recalculation of position limits; and (e) the advisability of an exemption for inter-commodity spread transaction. *Id*.

constraints on legitimate risk management activities within the cash-settled contract in the spot month that arise from (i) the presupposition that cash-settled contracts are fungible with physically-delivered contracts (which they are not); (ii) the use of an improper calculation that is tied to a specific deliverable point without considering that some hedgers use certain contracts not intending to make or take delivery at the specific delivery location; and (iii) the failure to consider seasonal fluctuations or trends in volume in re-calculating estimated deliverable supply.[7] We also noted our belief that the conditional cash-settled limit, which would be set at five times the spot month limit for those not holding any physically-settled contracts, likely would result in increased price volatility on the last day of trading.[8]

As the Commission again considers imposing federal position limits on physical commodity derivatives, we respectfully urge it to gather and examine carefully all relevant data and consider less onerous alternatives. Rulemaking related to position limits should be empirically driven and not a response to popular sentiment or partial analyses. The Commission itself noted that the studies on position limits "show a lack of consensus regarding the impact of speculation on commodity markets and the effectiveness of position limits."[9] In the NPRM, the Commission explains that it has based its determination that position limits are necessary on a minority of Commission-reviewed reports that support position limits, seemingly disregarding the other reports because those "[s]tudies that militate against imposing any speculative position limits" conflict with the Commission's understanding of what it believes to be a statutory mandate to implement position limits.[10] We believe the Commission has misinterpreted the statutory requirement of the Commodity Exchange Act ("**CEA**") and has not made an adequate finding with respect to the necessity of imposing position limits as further discussed in our letter.

[7] Letter from Richard H. Baker, President and CEO, Managed Funds Association, to David A. Stawick, Secretary, Commodity Futures Trading Commission (Mar. 28, 2011), *available at* http://www.managedfunds.org/wp-content/uploads/2011/06/3.28.11-MFA_Position_Limits_final.3.28.pdf [hereinafter "MFA 2011 Comment Letter"]. In the MFA 2011 Comment Letter, we also commented on the negative impact of the disaggregation relief, which would (i) too narrowly limit the ability to obtain such relief by eliminating the independent account controller exemption and replacing it with an owned non-financial entity exemption, and (ii) require an unnecessary application, approval and annual renewal exemption process inconsistent with operations of traders, especially passive traders, whom may not know of a position limits violation until after the filing deadline. MFA has commented on the Commission's separate rulemaking on aggregation of positions. *See* Letter from Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, Managed Funds Association, to Melissa D. Jurgens, Secretary, Commodity Futures Trading Commission (Feb. 7, 2014). The MFA 2011 Comment Letter also discussed the adverse effects of the (1) elimination of inter-commodity exemptions, which would inhibit standard investment practices used to capture inefficiencies between two commodities; (2) application of single month and all-months-combined limits to each class (futures and swaps) individually with no ability to net across classes; (3) lack of more specific information related to significant price discovery contracts that would be linked to referenced contracts, the rounding up to the nearest 100 contracts and the lack of hypothetical examples that demonstrate the application of the proposed position limits rules.

[8] MFA 2011 Comment Letter.

[9] Position Limits for Derivatives, 78 Fed. Reg. at 75,965.

[10] *Id*.

Nevertheless, MFA endeavors to work with the Commission in enhancing the proposed rules without compromising the integrity and vitality of the derivatives markets.

I. EXECUTIVE SUMMARY

MFA has carefully considered the NPRM and is providing its comments and recommendations, which are summarized as follows:

A. The Commission's necessity finding falls short of the statutory requirement, reinforced by the D.C. District Court's holding in *ISDA v. CFTC*, to make such a finding before imposing position limits. The Commission limits its necessity finding, incomplete as it is, to silver and natural gas, but it has proposed position limits on 28 core referenced futures contracts and all related referenced contracts. Further, the Commission's proposed limits do not strike the right balance amongst the prescribed statutory goals of diminishing excessive speculation and deterring market manipulation, and ensuring sufficient market liquidity for *bona fide* hedgers and the price discovery function of the underlying market.

B. The Commission's proposed rules create uncertainty surrounding the determination of which contracts will be deemed to be referenced contracts, especially with respect to customized OTC swaps. We are concerned that the Commission could determine retrospectively that a particular customized OTC swap is a referenced contract despite a good faith determination by a market participant that such swap is not a referenced contract, thus exposing the market participant to potential liability. The Commission should describe the methodology it used in determining the list of contracts that staff considers to be referenced contracts to provide clarity to market participants in their analysis of customized contracts.

C. MFA supports the Commission's flexible approach to the use of option valuation models in determining the futures equivalence of options for purposes of calculating compliance with position limits. The Commission should not impose a particular option valuation model. However, in granting flexibility to market participants, the Commission must not penalize persons that use reasonable option valuation models that do not produce the same results as the Commission's models. Accordingly, MFA recommends that the Commission explicitly provide: (1) that the use of a model that produces results within 10 percent of an exchange or Commission model is presumed to be a reasonable model unless the Commission can prove otherwise, and (2) that a person whose options model deviates by more than 10 percent from an exchange or Commission model may use such model if it can demonstrate that its use is reasonable under prevailing market conditions.

D. MFA believes that the Commission should not use the same methodology for both cash-settled and physically-delivered contracts for calculating spot-month position limits. Although there may be a valid rationale for establishing spot month position limits for physically-settled contract based on deliverable supply, there is no economic rationale for linking position limits on cash-settled contracts to deliverable supply.

E. MFA urges the Commission to determine estimated deliverable supply using the most recent and reliable data that is available to it.

F. MFA does not support any limits on cash-settled contracts. Among the three alternatives presented in the NPRM though, MFA believes the second alternative to the conditional spot-month limit exemption, which sets the limit for cash-settled contracts at five times the level of the limit for the physical-delivery core referenced futures contract regardless of a trader's positions in the underlying physical-delivery contract, will best preserve price discovery and market participation.

G. MFA contends that the Commission's approach to the establishment of non-spot month and all-months-combined position limits is too simplistic in its reliance on a uniform percentage of open interest applied to all referenced contracts. This one-size-fits-all methodology does not factor in seasonal fluctuations, other fluctuations based on trends, global events or economic forces, or traders' built-in cushions for the prevention of position limits violations, which likely will result in: (1) a self-reinforcing cycle of lower position limits; (2) no flexibility to modify position limits based on liquidity needs relating to external forces; and (3) position limits that are actually different for similar contracts traded on different exchanges because such contracts have different unit sizes. Moreover, we are concerned that the inaccuracy of the swaps data that is reported to the Commission undermines the establishment of appropriate non-spot month position limit levels.

H. The Commission should clarify that a mere bid or offer or indication of interest for an OTC swap in a referenced commodity that does not constitute a binding transaction *will not* count towards a market participant's position limit or be deemed to violate a position limit.

II. THE POSITION LIMITS PROPOSAL

The NPRM would significantly change the Commission's current position limits regime. The NPRM would:

A. Establish federal position limits for certain agricultural, metals, and energy commodities contracts (defined as core referenced futures contracts). The position limits proposal imposes position limits on derivatives based on the same 28 core referenced futures contracts as were previously proposed in the Vacated Rules. Positions subject to the position limits proposal would include (1) those in the core referenced futures contracts and (2) any derivative that is directly or indirectly linked to, including being partially or fully settled on, or priced at a fixed differential to, the price of (a) that particular core referenced futures contract or (b) that same commodity underlying that particular core referenced futures contract for delivery at the same location or locations as specified in that particular core referenced futures contract, but excluding any guarantee of a swap, a basis contract or a commodity index contract.

B. Establish aggregate (i.e., aggregating futures, options, including trade options, swaps, or swaptions in each contract) spot-month position limits for core referenced futures contracts. The spot-month position limits initially would be set at the levels currently imposed by designated contract markets ("DCMs") and later at levels equal to 25% of deliverable supply, as provided to the Commission by DCMs unless the Commission decides to rely on its own estimates. The spot-month limits would be applied separately for physically delivered and cash-settled contracts.

C. Establish a conditional spot-month limit that will permit traders to acquire position levels in cash-settled contracts that are five times the spot-month limit if such positions are exclusively in cash-settled contracts and provided that the trader does not hold or control any positions in the physical-delivery referenced contract based on the same commodity that is in such contract's spot month.

   The Commission has proposed three alternatives to the conditional spot-month limit:

   1. restricting the exemption to positions in cash-settled contracts that settle to an index based on cash-market transactions prices;

   2. setting the limit for cash-settled contracts at five times the level of the limit for the physical-delivery core referenced futures contract regardless of positions in the underlying physical-delivery contract; or

3. limiting cash-settled contracts that settle to the underlying physical-delivery to the same level as that of the underlying physical-delivery contract.

D. Adopt "single-month" and "all-months-combined" non-spot month position limits. The non-spot month position limits would be set as the sum of (i) 10% of the first 25,000 contracts; and (ii) 2.5% of open interest beyond 25,000 contracts. Under this approach, the Commission would eliminate the calendar-spread exemption within single-month limits (the Commission views such exemption unnecessary because it will set single-month limits at the same levels as all-months-combined limits). The minimum levels, however, would be set at the greater of the above calculation and 1,000 for referenced contracts in an agricultural commodity or 5,000 for referenced contracts in an exempt commodity. Physically-settled and cash-settled contracts would be netted for purposes of the single-month and all-months-combined limits.

E. Adopt a new, more restrictive, definition of *bona fide* hedging position for referenced contracts that requires the hedging transaction to represent cash market transactions and offset cash market risks (the "incidental test"), rather than transactions that would normally, but not necessarily, represent a substitute for cash market transactions or positions. All exemptions provided under the *bona fide* hedging exemption must satisfy two requirements: (1) the incidental test and (2) the "orderly trading requirement" (which imposes on hedgers the duty to establish and liquidate positions "carefully in the ordinary course of business").

In addition to the two requirements that must be satisfied for every *bona fide* hedging position, the exemption for excluded commodities requires that the "economically appropriate test" be satisfied. Such test requires that the position be economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise. The Commission has proposed guidance listing risk management positions that would qualify.

The *bona fide* hedging position definition also includes a new exemption for "pass-through swaps," *i.e.*, swaps entered into by a dealer with counterparties who may rely on the *bona fide* hedging exemption.

The exemption for physical commodities applies to futures, options, swaps and linked foreign futures contracts listed on a foreign board of trade that are economically equivalent to exchange-listed contracts. In addition to fulfilling the incidental test, orderly trading requirement and the economically appropriate test, a trader relying on this exemption must satisfy the "change in value requirement" (*i.e.*, the position arises from the potential change in value of assets, liabilities or services) and the "temporary substitute test" (*i.e.*, the position is a substitute for a position to be taken on in the future in the physical marketing channel).

The *bona fide* hedging definition lists other enumerated exemptions, including a cross-commodity hedge, among several others. The unfilled storage capacity hedge exemption is not included, however.

F. Establish reporting requirements by substantially revising Part 19. Such revisions will extend reporting requirements to any person claiming an exemption from federal position limits, add new Forms 504, 604 and 704 to facilitate such reporting, and update the type of data to be reported and the time allotted to submit such reports.

G. Provide an exception for pre-existing positions. In the spot-month, only certain swaps (depending on the time at which they were entered into) are exempted. For non-spot months, pre-existing positions in commodity derivative contracts acquired before the effective date of the position limits rules are exempted. However, certain swaps will not be exempted if a trader has increased its position after the effective date of the position limits rules.

H. Provide that the aggregate position limits would apply to a trader's positions in referenced contracts that settle to a referenced contract that are executed on or subject to the rules of a foreign board of trade that allows direct access to its trading system for participants located in the U.S.

III. COMMENTS TO THE POSITION LIMITS PROPOSAL

A. Section 4a of the Commodity Exchange Act Mandates that the Commission Make Specific Findings Before it May Impose Position Limits

1. The Commission has not fulfilled its statutory obligation to make a necessity finding before imposing position limits.

Section 4a(a)(1) of the Commodity Exchange Act (the "**Act**"), as amended, sets forth the Commission's broad authority to set such position limits as the Commission finds are necessary to diminish, eliminate, or prevent such burden to interstate commerce caused by excessive speculation that causes sudden or unreasonable fluctuations or unwarranted changes in the price of such commodity. Section 737 of the Dodd-Frank Act[11] added Sections 4a(a)(2) through (7) to the Act. Section 4a(a)(2) authorizes the Commission, in accordance with the standards set forth in Section 4a(a)(1) described above, with respect to physical commodities (agricultural, metals,

[11] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111–203, 124 Stat. 1376 (2010).

and energy, but not excluded commodities such as interest rates, currencies, or stock indices) to establish limits on the amount of positions, as appropriate, other than *bona fide* hedge positions. The legislative history of the Dodd-Frank Act indicates that the Commission's setting of position limits is intended to be an authorized, rather than a required, action.[12] Section 4a(a)(3) of the Act specifies that if the Commission establishes the limits in Section 4a(a)(2), it must set limits on the number of positions that may be held by any person for the spot month, each other month, and the aggregate number of positions that may be held by any person for all months, to the maximum extent practicable, in its discretion, to 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.[13]

In the NPRM, the Commission argues that "it is reasonable to construe [section 4a(a) of the Act] to mandate that the Commission impose position limits."[14] In doing so, it appears that the Commission misinterprets the statute and the holding of the D.C. District Court in *ISDA v. CFTC*. The court in *ISDA* stated that there were at least two plausible readings of the statute: the CFTC's reading and the plaintiffs' interpretation, but went on to say that the CFTC's interpretation "renders other parts of Section [4a] mere surplusage."[15] The court continued, "Significantly, [the CFTC's interpretation] fails to give any meaningful effect to the very first clause of Section [4a(a)(2)], which requires that the CFTC establish position limits '[i]n accordance with the standards set forth' in subsection (a)(1)."[16]

The D.C. District Court found that section 4a(a)(1) "clearly and unambiguously requires the Commission to make a finding of necessity prior to imposing position limits."[17] Throughout its opinion, the court found that there is a clear statutory requirement that the Commission make

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[12] See S. Rept. 111-176 (Apr. 30, 2010), "This section authorizes the CFTC to establish aggregate position limits across commodity contracts listed by designated contract markets, commodity contracts traded on a foreign board of trade that provides participants located in the United States with direct access to its electronic trading and order matching system, and swap contracts that perform or affect a significant price discovery function with respect to regulated markets." (emphasis added).

[13] Section 4a(a)(5) of the Act requires the Commission to establish limits on the amount of positions, as appropriate, other than *bona fide* hedge positions, that may be held by any person with respect to swaps that are economically equivalent to futures or options contracts traded on a DCM. In establishing these limits, the Commission must address similar requirements as those described in Section 4a(a)(3) described above.

[14] Position Limits for Derivatives, 78 Fed. Reg. at 75,681.

[15] *International Swaps and Derivatives Association v. U.S. Commodity Futures Trading Commission*, 887 F.Supp.2d 259, 279 (D.D.C. 2012).

[16] *ISDA*, 887 F.Supp.2d at 279-80.

[17] *Id*. at 269 ("The precise question, therefore, is whether the language of Section [4a(a)(1)] clearly and unambiguously requires the Commission to make a finding of necessity prior to imposing position limits. The answer is yes.").

a necessity finding before imposing position limits.[18] However, the Commission continues to construe section 4a(a)(1) of the Act as a Congressional mandate requiring the Commission to establish position limits.[19] The Commission states: "The Commission also concludes that the mandate requires it to impose such limits without first finding that any such limit is necessary to prevent excessive speculation in a particular market."[20] However, "out of an abundance of caution," the Commission makes a preliminary finding that position limits are necessary as a prophylactic measure, and cites to two examples that purportedly support its contention.[21] The Commission cites to the Hunt Brothers scenario in the silver futures market of the late 1970s and the events in the natural gas futures market during the mid-2000s where Amaranth Advisors, LLC held derivatives that equated to up to 5 percent of the natural gas used in the U.S. in a year, but did not own or control any physical natural gas.[22]

In describing these two scenarios, the Commission itself recognizes the ability of exchanges to react to price turbulence, and specifically cites to the Chicago Board of Trade and Commodity Exchange, Inc.'s responses to the Hunt Brothers scenario, whereby both exchanges implemented emergency rules that imposed position limits, increased margin requirements and limited trading to liquidation purposes only.[23] Yet, using these two cases, the Commission seeks to justify the broad imposition of federal speculative position limits on the market as a whole – specifically, on 28 core referenced futures contracts and related "referenced contracts," including options and swaps contracts. MFA is concerned that the Commission's "necessity" finding is described in a vacuum – the Commission discusses only two scenarios, related to only two commodities, and does not reference the impact of new developments in the marketplace and new tools available to the Commission.

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[18] *Id*. at 270 ("The text does not state (nor has it ever) that the CFTC may do away with or ignore the necessity requirement in its discretion. There is no ambiguity as to whether the statute requires the CFTC to make such findings, and the CFTC has never apparently treated the statute as ambiguous on this point. Accordingly, the Court concludes that § [4a(a)(1)] unambiguously requires that, prior to imposing position limits, the Commission find that position limits are necessary to 'diminish, eliminate, or prevent' the burden described in Section [4a(a)(1)]."); 271 ("Section [4a(a)(1) contains a clear statutory requirement that the CFTC find that any position limits 'are necessary to diminish, eliminate, or prevent' the burden on interstate commerce described in the statute."); 272 ("As set forth above, the language of Section [4a(a)(1)] is clear and unambiguous regarding the Commission's duty to make a necessity finding."); and 273 ("As Plaintiffs correctly note, '[w]hat the plain language of Section [4a(a)(1)] does not permit is the establishment of position limits – whether prophylactic or remedial – without any necessity finding at all." (internal citations omitted)).

[19] Position Limits for Derivatives, 78 Fed. Reg. at 75,681.

[20] *Id*. at 75,681-82 (emphasis added).

[21] *Id*. at 75,685.

[22] Position Limits for Derivatives, 78 Fed. Reg. at 75,691.

[23] Position Limits for Derivatives, 78 Fed. Reg. at 75,685-86.

2. *The Commission's proposed limits do not strike the right balance among the prescribed statutory goals of diminishing excessive speculation and deterring market manipulation, and ensuring sufficient market liquidity for bona fide hedgers and the price discovery function of the underlying market.*

Although the Dodd-Frank Act provides the Commission with discretion and does not specify what weight the Commission must give to each of the four goals enumerated in Section 4a(a)(3) of the Act,[24] the Dodd-Frank Act requires the Commission to maximize to the extent practicable each of these four goals when setting limits. Congress requires balance in establishing limits, and in seeking to further one objective (e.g., preventing excessive speculation), the Commission needs to do so in a manner that does not adversely affect another objective (e.g., ensuring liquidity). MFA believes that the Commission has not struck the appropriate balance among these four goals, but instead has focused on addressing the fear of excessive speculation and market manipulation at the expense of ensuring sufficient market liquidity and price discovery. Further, MFA believes that the Commission has not adequately considered, as required under Section 4a(a)(2)(C) of the Act, whether the NPRM will cause price discovery in the referenced commodities to shift to trading on foreign boards of trade.[25] The referenced contracts are global commodities that are traded worldwide; therefore, the Commission should not implement rulemaking until there is global cooperation on position limits, otherwise U.S. markets will be disadvantaged.

3. *Speculation Actually Benefits the Marketplace*

Extensive studies have been undertaken by public and private institutions around the world on speculative position limits; in fact, the Commission cites to many of the same studies MFA has reviewed.[26] However, in discussing only the Hunt Brothers and Amaranth case studies

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[24] Section 4a(a)(3) of the Act specifies that if the Commission sets federal position limits, it must strive to 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).

[25] Section 4a(a)(2)(C) states, "In establishing the limits required under subparagraph (A), the Commission shall strive to ensure that trading on foreign boards of trade in the same commodity will be subject to comparable limits and that any limits to be imposed by the Commission will not cause price discovery in the commodity to shift to trading on the foreign boards of trade." The Commission does not provide an analysis of whether price discovery will shift to a foreign board of trade. *See* Position Limits for Derivatives, 78 Fed. Reg. at 75,766.

[26] Position Limits for Derivatives, Appendix A, 78 Fed. Reg. at 75,784. Many of these reports relate to the energy price volatility of 2007-2008, and seek to identify and explain the underlying factors. MFA has found that reputable research and commentary from a range of sources have concluded that fundamental factors of supply and demand, along with economic factors such as the decline in the U.S. dollar, were primarily responsible for price volatility. *See, e.g.*, GAO Briefings to the House Committee on Agriculture on Issues Involving the Use of Futures Markets to Invest in Commodity Indexes (Dec. 2008), International Organization of Securities Commission's Technical Committee (IOSCO) Final Report (Mar. 2009), IMF World Economic Outlook (Oct. 2008), HM Treasury Global Commodities: A long term vision for stable, secure and sustainable global markets (June 2008), CME Group white

the Commission has not given adequate weight to the benefits that speculators provide to the market. Speculators such as funds absorb risk from hedgers and provide liquidity to both sides of the market.[27] Producers and users rarely meet directly, given the different sizes, durations, and specifications of their needs, and instead rely on speculators to take the opposite position. In a study by the OECD, research found that there was a negative correlation between speculative positions and market volatility, concluding that "there is some consistent evidence that increases in trader positions are followed by lower market volatility."[28] This follows on studies by Haigh, Hranaiova and Overdahl, which found that "hedge funds [do] not affect price levels in energy futures markets, yet[…] are very important to the functioning of the market through the liquidity they provide to other participants," and by Commission staff, which observed that "hedge fund

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paper "Excessive Speculation and Position Limits in Energy Derivatives Markets," available at http://cmegroup.com/company/files/PositionLimitsWhitePaper.pdf, *Dr Evil, or drivel? The charge-sheet against commodity speculators is flimsy*, Economist, Nov. 11, 2010 ("In fact there is little empirical evidence that investors cause more than fleeting distortions to commodity prices. The most persuasive explanation for the rises and falls of commodities is demand and supply."), Irwin, Scott. H., and Sanders, Dwight R., The Impact of Index and Swap Funds on Commodity Futures Markets: Preliminary Results, OECD Food, Agriculture and Fisheries Working Papers, No. 27, OECD Publishing (2010); and Lawrence Eagles, J.P. Morgan, "With Better Data, Better Understanding" (Jan. 27, 2009).

To illustrate this conclusion, between December 31, 2007 and June 30, 2008, when the NYMEX Crude Oil price rose from $96 to $140 per barrel, open interest rose from 2.5 million to 2.8 million contracts, but the commodity index investment (i.e., speculative investment) fell from 408,000 to 363,000 open long contracts. Commission staff summarized this result stating:

> While the net notional value of commodity index business in NYMEX WTI crude oil increased sharply over the 6-month period ending on June 30, 2008—by about 30 percent, the actual numbers of equivalent long futures contracts declined over that same period by about 11 percent. In other words, the sharp rise in the net notional value of commodity index business in crude oil futures appears to be due to an appreciation of the value of existing investments caused by the rise in crude oil prices and not the result of more money flowing into commodity index trading.

CFTC Staff Report on Commodity Swap Dealers & Index Traders (Sept. 2008). There was no evidence to indicate that excessive speculation was to blame, as speculators were actually reducing their long positions during this period. *See, e.g.*, "Commodity Price and Futures Positions" (Dec. 16, 2009), Ruy Ribero, Lawrence Eagles and Nicholas von Solodkoff, J.P. Morgan; "We can safely say there is no indication in this data of the fact speculators are pushing the price of oil," Christophe Barret, global oil analyst at Credit Agricole, quoted in Energy Risk (Apr. 13, 2010), available at http://www.risk.net/energy-risk/news/1600919/cftc-speculators-influence-commodity-markets; Prepared Testimony of Philip K. Verleger, Jr., Haskayne School of Management, University of Calgary, PKVerleger LLC, to Commodity Futures Trading Commission on The Role of Speculators in Setting the Price of Oil (Aug. 5, 2009); "Speculators Cleared in U.K. Oil Volatility" (July 28, 2009), *The Wall Street Journal*; and CFTC Interagency Task Force on Commodity Markets, Interim Report on Crude Oil.

[27] "The short hedgers and long investors provide liquidity for each other by using futures markets to serve their respective interests in an open, transparent and efficient manner. Liquidity will be essential to make sure each can achieve their objectives at an efficient price. Artificial limits on that liquidity should not be imposed. There are numerous ways to further the objectives of enhanced transparency and reduced systemic risk that do not involve reductions in much needed liquidity." Prepared Statement Before the Commodity Futures Trading Commission of Kevin Norrish, Managing Director of Commodities Research, Barclays Capital (Mar. 25, 2010).

[28] Irwin, S. H. and D. R. Sanders, "The Impact of Index and Swap Funds on Commodity Futures Markets: Preliminary Results," OECD Food, Agriculture and Fisheries Working Papers, No. 27, OECD Publishing (2010), digital object identifier: 10.1787/5kmd40wl1t5f-en.

trading activity is beneficial in that it contributes to bringing in line the prices of commodity futures at different maturities."[29] The availability of speculators to take long and short positions, bring in new information, and express countervailing views, helps complete the market for hedgers, smooth out volatility, and aid in price discovery. While the term "speculator" is an age-old technical designation, it has unfortunately taken on a pejorative connotation in recent years, which detracts from this important role.

Position limits, even purportedly generous ones, may impair the ability of markets to serve their essential risk shifting function, which would increase the cost of managing risk and harm hedgers, and ultimately consumers of these products. Studies have demonstrated that on prior occasions where trading by investors was restricted, such as by prohibiting futures transactions in certain commodities (Chicago onions, Berlin wheat), the result was significantly greater, and not less, price volatility.[30] Studies comparing price volatility in various commodities (wheat, cotton, oats, sugar, butter, eggs, rubber, silk, copper, silver, lead, zinc, soybeans, linseed, and hogs) before and after the establishment of futures markets for such commodities also demonstrate that futures markets are associated with lower price volatility.[31] Longstanding research, including studies conducted by the Commission, has shown that speculators and index funds perform an essential function in the commodity markets by transferring risk from commercial participants, providing liquidity, reducing volatility, and contributing to the price discovery process, which benefits hedgers and all consumers and producers of the commodities.[32]

MFA contends that the best available evidence discounts the theory that there is excessive speculation distorting the prices in the commodity markets. Accordingly, we believe that it would be inappropriate to adopt the NPRM given the weight of the evidence and that the position limits proposed in the NPRM will place a greater burden on interstate commerce by hindering the ability of derivatives markets to (i) ensure that the price discovery function of the

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[29] See Büyükşahin, Haigh, Harris, Overdahl and Robe, Fundamentals, Trader Activity and Derivative Pricing (Dec. 4, 2008), *available at* http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/marketreportenergyfutures.pdf.

[30] "At a minimum, there is no evidence for the claim that futures markets are associated with higher price volatility. Indeed, the results presented in this paper strongly suggest the opposite: futures markets were associated with, and most likely caused lower commodity price volatility." "Populists versus theorists: Futures markets and the volatility of prices" (June 2006), Explorations in Economic History 44 (2007) 342-362, at 357, David S. Jacks ("Jacks Study"), available at www.sciencedirect.com.

[31] Jacks Study, at 352.

[32] *See, e.g.*, "A Review of Recent Hedge Fund Participation in NYMEX Natural Gas and Crude Oil Futures Markets," New York Mercantile Exchange, Mar. 1, 2005; "Price Dynamics, Price Discovery and Large Futures Trader Interactions in the Energy Complex, Working Paper First Draft: Apr. 28, 2005," Michael S. Haigh, Jana Hranaiova, and James A. Overdahl, Office of the Chief Economist, U.S. Commodity Futures Trading Commission ("Commission Energy Complex Report"); Testimony of Craig Pirrong, Professor of Finance, Director, Global Energy Management Institute, Bauer College of Business, The University of Houston, Before the House Committee on Agriculture (July 7, 2008) ("Pirrong Testimony"); Jacks Study at 342-362.

underlying market is not disrupted; and (ii) perform their fundamental risk transfer and risk management functions, both of which depend on the existence of liquid, fair and competitive markets to ensure sufficient market liquidity for *bona fide* hedgers.[33]

4. The Commission's proposed limits are a flawed cure for a problem that the Commission has not found to exist.

MFA believes that the prophylactic steps the Commission proposes are flawed and are potentially harmful to the health of the market. Although position limits may reduce the ability of persons with market power to squeeze or corner the market, they have been described as a crude and inefficient tool.[34] This is because it is difficult to set the limits at a level that inhibits market manipulation without unduly affecting the ability of markets to efficiently transfer risk. We recommend alternatives to using such a blunt instrument.

MFA believes that the proposed position limits will potentially reduce liquidity in U.S. derivatives markets. Aside from the overall imposition of position limits, there are several other aspects of the NPRM that we believe will significantly impact liquidity in the derivatives markets. Additionally, MFA questions whether the Commission's approach will promote the goal of preserving market integrity. If the imposition of position limits on U.S. futures exchanges and swap execution facilities drives more trading offshore, the Commission will have more difficulty conducting effective market surveillance and preventing potential price manipulation in the underlying commodities.

Better alternatives than position limits are presently available to the Commission to deter market manipulation. Through the use of the current position reporting and market surveillance regime, and the ability to impose penalties for disruptive market behavior, the Commission and exchange surveillance staff can detect and prevent corners, squeezes, and other forms of manipulation. It is preferable, therefore, to use readily available market data and the Commission's statutory authority to investigate and prosecute aggressive traders that manipulate or attempt to manipulate the market, than to limit the trading activity of all other market participants through position limits. An effective enforcement regime will discourage manipulation and assure a proper balance – preventing excessive speculation and deterring market manipulation, while ensuring sufficient market liquidity and price discovery.[35]

MFA believes that, when the Commission exercises its regulatory oversight authority, it must be cognizant of the effect of the proposed federal limits on the ability of futures markets to

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[33] *See, e.g.*, Pirrong Testimony, at 3.

[34] Pirrong Testimony, at 5.

[35] The Commission recognizes that there is academic support for this notion, and cites to a study by Craig Pirrong ("Squeezes, Corpses, and the Anti-Manipulation Provisions of the Commodity Exchange Act," Oct. 1, 1994). Position Limits for Derivatives, 78 Fed. Reg. at 75,695.

perform their fundamental price discovery, risk transfer, and risk management functions, which depend on the existence of liquid, fair, and competitive markets. Therefore, any proposal that would tend to adversely affect the liquidity, fairness or competitiveness of the futures markets must be carefully scrutinized. MFA disagrees with the Commission's finding that position limits are necessary or appropriate, and does not believe that position limits are an effective tool to address excessive speculation. Nevertheless, if the Commission determines that position limits are necessary, MFA provides the suggestions below intended to assist the Commission with its policy objectives without compromising the integrity of the market and in a manner that is less disruptive to the liquidity of the market and to the operations of market participants.

B. The Commission Should Provide Clear Guidance on Referenced Contracts and the Economic Equivalence Determination

MFA recommends that the Commission issue clearer guidance as to how it determines when a contract is a "referenced contract." Clarity is needed to help prevent inadvertent violations of position limits that could occur when a person makes its own determination, as it must, as to whether a contract is a referenced contract. The Commission proposes to impose position limits on referenced contracts, which include, generally, futures, options and swaps contracts that are directly or indirectly linked to the price of a particular core referenced futures contract or the price of the same commodity underlying the particular core referenced futures contract for delivery at the same location or locations as specified in the particular core referenced futures contract.[36] Swaps that are "economically equivalent" to futures and options contracts fall within the position limits regime, but the meaning of "economically equivalent" is unclear because neither the statute nor the Commission defines this term.[37] Rather, the Commission interprets this term to require that a swap satisfy the definition of "referenced contract" to determine whether the swap is within the position limits regime, noting that any other similarities or differences that exist between futures and swaps *are not material* to making this determination.[38] The Commission should provide clearer guidance on its interpretation of economical equivalence so market participants can more effectively determine whether a swap is within the position limits regime.

While the Commission has explicitly listed the core referenced futures contracts in a table in proposed rule 150.2(d), it has not provided the same certainty with respect to referenced contracts in the proposed rules. Instead, the Commission has posted to its website a list of 464 contracts with Commission staff's views on whether specific contracts would be deemed to be

[36] Proposed rule 150.2(d) at 75,826 (imposing speculative position limits on referenced contracts); proposed rule 150.1 at 75,825 (defining referenced contracts).

[37] Position Limits for Derivatives, 78 Fed. Reg. at n. 378, 75,723.

[38] *Id*. (emphasis added).

"in" or "out" of the position limits regime.[39] The list is helpful as far as it goes. However, the Commission's list appears to address only exchange-listed contracts. We believe the Commission should provide examples of OTC contracts, and contracts traded on a foreign board of trade, to the extent there are economically equivalent contracts.

Moreover, the Commission did not describe the methodology it used in compiling this list of referenced contracts or provide related guidance. Nor is there any discussion of whether and how this list will be updated or maintained. As a result, market participants will not be able to compute their positions with regulatory certainty, but will be required to exercise their judgment and make good faith determinations to resolve whether a contract that is not on the list, especially a customized swaps contract, is a referenced contract.

MFA believes that the Commission should describe the approach it intends to take with respect to customized contracts. MFA recommends that the Commission make clear that it will not take enforcement action against a person that can demonstrate that it had a reasonable basis for determining that a particular contract was not a referenced contract. In the absence of specific Commission guidance, the Commission should not use a strict liability standard to find violations of position limits by a person that has reasonably calculated its positions in good faith. Further, MFA recommends that the Commission make the list of referenced contracts formal guidance, and publicly announce and publish for comment each time the Commission wishes to add contracts to or remove contracts from the list. In relation to such additions or removals, the Commission should establish an implementation and transition period to allow market participants to incorporate the change in contract status into their calculations.

C. The Commission Should Address the Computational Challenges for Options

MFA supports the Commission's proposal that does not mandate a specific option valuation model to be used by persons in calculating the futures equivalent[40] value of an option for purposes of calculating position limits. However, the absence of a standardized model may

[39] CFTC Staff Workbook of Commodity Derivative Contracts Under the Proposed Regulations Regarding Positions Limits for Derivatives, *available at* http://www.cftc.gov/LawRegulation/DoddFrankAct/Rulemakings/PositionLimitsforDerivatives/ssLINK/poslimitsworkbook.

[40] The NPRM defines "futures equivalent" to mean:

> (1) An option contract, whether an option on a future or an option that is a swap, which has been adjusted by an economically reasonable and analytically supported risk factor, or delta coefficient, for that option computed as of the previous day's close or the current day's close or contemporaneously during the trading day, and;
>
> (2) A swap which has been converted to an economically equivalent amount of an open position in a core referenced futures contract.

Proposed rule 150.1, 78 Fed. Reg. at 75,825.

give rise to regulatory uncertainty, which the Commission should seek to alleviate. MFA recommends that the Commission provide guidance on whether the Commission will deem an option valuation model to be unsatisfactory and, if so, the factors the Commission would consider in arriving at such an opinion. MFA also recommends that the Commission adhere to a reasonableness approach by explicitly providing that (1) a model that produces results within 10 percent of an exchange or Commission model is presumed to be a reasonable model unless the Commission can demonstrate otherwise, and (2) a person whose model deviates by more than 10 percent from an exchange or Commission model may use such model if it can demonstrate that its model is reasonable under prevailing market conditions.

Market participants use different option valuation models, often proprietary, to convert options into futures equivalents, and should be permitted to rely on the outputs of these models when calculating position limits. The Commission has not, and MFA agrees that it should not, prescribe a specific option valuation model that all persons must use to calculate position limits. However, the Commission should provide guidance on the factors it will use to determine whether a model is "economically reasonable and analytically supported."[41] MFA believes that the Commission should not second guess the results of reasonable models and impose findings of violations after-the-fact. To do so would introduce tremendous uncertainty into compliance with the position limits regime. Therefore, MFA recommends that the Commission adhere to the approach described above, which would explicitly provide that (1) the use of a model that produces results within 10 percent of an exchange or Commission model is presumed to be a reasonable model unless the Commission can demonstrate otherwise, and (2) a person whose model deviates by more than 10 percent from an exchange or Commission model may use such model if it can demonstrate that its model is reasonable under prevailing market conditions.

MFA further recommends that the Commission consider the exchanges' approach to option valuation where appropriate because these approaches are already in use and familiar to market participants. For example, CME Rule 562 provides that, "if, at the close of trading, a position that includes options exceeds position limits when evaluated using the delta factors as of that day's close of trading, but does not exceed the limits when evaluated using the previous day's delta factors, then the position shall not constitute a position limit violation."[42] MFA encourages the Commission to adopt a similar provision in its position limits rules.

D. Position Limits Should Be Based on Current Estimated Deliverable Supply Data and Transparency

MFA recommends that the Commission use current data to calculate estimated deliverable supply. Estimated deliverable supply, which is used for setting both exchange and CFTC spot-month limits, must have a reasonable correlation to actual deliverable supplies. We

[41] *See, e.g.*, proposed rule 150.1, 78 Fed. Reg. at 75,825.

[42] CME Rulebook, Rule 562, *available at* http://www.cmegroup.com/rulebook/CME/I/5/5.pdf.

understand from the analysis conducted by the CME Group, Inc. that the Commission has not approved new estimates of deliverable supply for many commodity contracts covered by the NPRM—in some cases for over decades. For example, estimated deliverable supply for natural gas has not been updated since 1996 and gold and silver have not been updated since 1983. Using outdated information to establish position limits has the practical effect of creating position limits that are too low and not reflective of current market conditions. CME Group, Inc. has provided the Commission with updated deliverable supply estimates, which should result in higher spot-month limits based upon the Commission's proposed spot-month position limits calculation that is 25% of deliverable supply. However, the Commission has proposed that it base position limits on CME's more recent data only as an alternative approach.[43] MFA supports the Commission's alternative approach that would use more recent estimated deliverable supply data to establish position limits for the spot month.

MFA has concerns with respect to the Commission's proposed "deliverable supply" definition, similar to those raised in previous proposals.[44] In response to previous comments requesting greater certainty on deliverable supply, the Commission modified the Vacated Rules in just one respect, explicitly permitting DCMs to use Commission guidance for purposes of calculating deliverable supply.[45] However, the guidance to which the Commission refers, Appendix C to Part 38, is broad, vague and subject to different interpretations amongst the DCMs and other market participants. For example, the Commission has not provided clear guidance on the inclusion of remotely located commodities in the deliverable supply computation, or whether certain conditions must first exist before the inclusion of such commodities is appropriate. As such, it is difficult to determine whether the Commission's proposal to base position limits on estimated deliverable supply will result in too narrow or too broad a calculation.

MFA respectfully recommends that the Commission use this opportunity to address the concerns of industry stakeholders, and provide greater clarity on deliverable supply. For example, MFA welcomes guidance on barge traffic and specifically requests that the Commission confirm that commodities transported to the delivery point and priced within a specified percentage of the prevailing spot price for the relevant commodity at the delivery point are appropriately included in a DCM's estimated deliverable supply calculation. In doing so, the Commission will provide a more objective and transparent method of determining whether barge traffic carrying a commodity would fall within estimated deliverable supply.

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[43] Position Limits for Derivatives, 78 Fed. Reg. at 75,727.

[44] Previous commenters on the Vacated Rules expressed concerns with the Commission's unclear definition of deliverable supply. These commenters included the International Swaps and Derivatives Association, Securities Industry and Financial Markets Association, Alternative Investment Management Association, National Grain and Feed Association and CME Group, Inc., among others. *See* Position Limits for Futures and Swaps, 76 Fed. Reg. at 71,633.

[45] *Id*. at 71,634.

E. The Commission Should Not Impose Position Limits for Cash-Settled Contracts and, in the alternative, Position Limits for Cash-Settled Contracts Should Not Be Based on Estimated Deliverable Supply

In previous comment letters, MFA urged the Commission to reconsider the imposition of position limits based on estimated deliverable supply on cash-settled contracts, and continues to recommend that the Commission do so.[46] Although deliverable supply is an appropriate basis for setting limits on physically-settled contracts because those contracts involve the making and taking of delivery and have an impact on a commodity's settlement price, the same is not true of cash-settled contracts. As we have previously contended, there is no economic relationship or rationale for linking position limits on cash-settled contracts to deliverable supply, and the imposition of equal position limits for cash-settled and physically-delivered contracts is based on the incorrect assumption that cash-settled and physically-delivered contracts are fungible. As a result, the position limits for cash-settled contracts may unnecessarily constrain legitimate risk management activity with the cash-settled contract in the spot month. Accordingly, MFA recommends that the Commission adopt final rules that <u>do</u> <u>not</u> impose position limits on cash-settled contracts.

In the event that the Commission decides to impose position limits on cash-settled contracts, MFA urges the Commission to reconsider using estimated deliverable supply to calculate such position limits. Estimated deliverable supply is tied to a given delivery point and, as such, is a misguided approach for cash-settled contracts – certain benchmark contracts, such as the NYMEX Henry Hub Natural Gas contract, are widely used by a range of commercial hedgers to manage their risks. In many instances, the hedger has no intention of making or taking delivery at the Henry Hub, but rather uses the cash-settled contract for its superior liquidity and price discovery to hedge risks in other locations or for other commodities with significant natural gas inputs. By limiting the calculation of deliverable supply only to this one point in Erath, Louisiana, however, the Commission would be ignoring the sizable hedging activity in cash-settled contracts and arrive at a number far too low to accommodate this type of activity. The Commission's one-size-fits-all approach does not give due consideration to market dynamics.

F. The Commission Should Adopt the Second Alternative to the Conditional Spot-Month Position Limit Exemption

MFA has specific concerns about the Commission's proposed rule 150.3(c), which would prohibit traders from acquiring positions in the spot-month physical-delivery referenced contract. Under the Commission's proposal, a trader could acquire positions up to five times the spot-month limit in cash-settled contracts as long as the trader does not hold or control any positions in the spot-month physical-delivery referenced contract. In response to concerns regarding the

[46] MFA 2010 Comment Letter at 15-16; MFA 2011 Comment Letter at 16-17.

proposed conditional spot-month position limit exemption's impact on the price discovery function of the physical-delivery market and liquidity for *bona fide* hedgers in the physical-delivery contracts, the Commission has proposed three alternatives to the proposed conditional spot-month position limit exemption. The first alternative restricts the exemption to positions in cash-settled contracts that settle to an index based on cash-market transactions prices. The second alternative sets the limit for cash-settled contracts at five times the level of the limit for the physical-delivery core referenced futures contract regardless of positions in the underlying physical-delivery contract. The third alternative limits cash-settled contracts that settle to the underlying physical-delivery to the same level as that of the underlying physical-delivery contract. MFA supports the Commission's second alternative to the proposed conditional spot-month limit exemption.

MFA supports this alternative because of the concern that proposed rule 150.3(c) would unnecessarily constrain funds in their day-to-day trading. For example, for a fund with multiple trading strategies, some of which use physically-delivered contracts and others use cash-settled contracts in the same commodity, the proposed rule's prohibition on holding any positions in the physical-delivery contract would severely constrain the fund's trading strategies. Thus, this type of fund would be blocked from one market altogether and unnecessarily constrained. Another concern is that proposed rule 150.3(c) may incentivize some traders to trade only in the cash-settled contract, adversely affecting price discovery and liquidity in the physical-delivery contract. The Commission should strive to promote price discovery and market participation. Proposed rule 150.3(c) has the opposite effect. The second alternative would allow traders to implement multiple trading strategies without blocking them from certain markets or unnecessarily constraining their trading strategies. Therefore, MFA recommends that the Commission adopt the second alternative to the conditional spot-month position limit exemption.

G. The One-Size-Fits-All Approach to Setting Non-Spot Month and All-Months-Combined Limits Fails to Incorporate Market Realities Unique to Specific Commodities

MFA has several concerns regarding the non-spot month limit proposals, and seriously questions the necessity of an all-months-combined limit when settlement occurs at a future point in time and contracts are subject to spot month limits at such time. The Commission's application of the same percentage of open interest to non-spot month and all-months-combined position limits and the calculation of these position limits based on incomplete data are issues that should be addressed to facilitate the operation of the position limits regime with as little disruption and uncertainty as possible.

MFA continues to be concerned that the Commission is choosing a uniform, one-size-fits-all approach to setting position limits. MFA has commented on this issue in the past,[47] and now respectfully requests the Commission to seriously consider the implementation of more

[47] MFA 2010 Comment Letter at 7; MFA 2011 Comment Letter at 10.

appropriate position limits for different commodities. For example, the Commission treats all commodities in the same manner by setting position limits at 10% of open interest on the first 25,000 contracts and 2.5% on contracts over 25,000.[48] We do not believe that this approach recognizes the differing characteristics among markets. Different commodities have unique characteristics based on seasonality, trends and fluctuations based on other events.

If position limits are based on an arbitrary and uniform percentage of open interest, such limits will not factor in seasonality or macro-economic trends, thereby causing position limits to lag behind market trends. Open interest can change dramatically from year to year depending on external events that impact prices, such as regime change in commodity-producing countries, significant changes in weather or economic events. Position limits should be a function of the liquidity of the market, which would prevent a cycle causing open interest to continually decrease year after year from occurring. If a slow year is followed by a more active year due to macro events, the position limits will limit liquidity when it is most needed. For example, open interest in NYMEX WTI reached record levels in 2011 due to the Arab Spring in countries such as Egypt and Libya.[49] More recently, exchanges with the flexibility to respond to market conditions have increased position limits on electricity contracts necessitated by the "polar vortex" weather conditions that most of the U.S. and Canada experienced in January 2014.[50] Limits that do not respond quickly to these types of global events, seasonal trends or other economic forces may limit liquidity. MFA recommends that the Commission adopt final rules that give the Commission the flexibility to increase position limits immediately or with little delay so that the market can accurately respond to external forces without violating position limits. Alternatively, the Commission should include peak open interest levels beyond the most recent two years when it determines the level of open interest on which to base position limits.

MFA notes that the Commission has not explained the reasons for applying the agricultural model to the energy and metals markets, especially in view of the different characteristics that distinguish these markets. For example, the energy and metals markets are more global, energy and metals commodities are more fungible, supplies of energy and metals commodities are much greater, and energy commodities production is subject to less seasonal variation than agricultural commodities. Moreover, the fact that contract sizes are not uniform across exchanges mandates that a different approach be taken, specific to the unique characteristics of various contracts. For example, a trader could hold one contract of a Henry Hub natural gas future (or 10,000 mmBtu)[51] and another trader could hold one contract of a

[48] Proposed rule 150.2(e)(4), Position Limits for Derivatives, 78 Fed. Reg. at 75,827.

[49] Press Release, CME Group, CME Group Announces Three Consecutive Open Interest Volume Records in Benchmark Light Sweet Crude Oil (WTI) Futures (Mar. 14, 2011).

[50] Gregory Meyer, *Big Bets on Power Cleared by Regulator*, FIN. TIMES (Jan. 21, 2014).

[51] CME Group Contract Specifications, *available at* http://www.cmegroup.com/trading/energy/natural-gas/natural-gas_contract_specifications.html.

PG&E Citygate Index future (or 2,500 mmBtu).[52] The former trader holds four times as much British thermal units of natural gas than the latter trader because the contract sizes are different. However, the Commission's one-size-fits-all approach to open interest does not take into account this type of discrepancy.

Although MFA has previously commented[53] on the built-in bias towards lower position limits within the recalculation of position limits, the Commission does not appear to have addressed our concerns. Under the proposed rules, the Commission will calculate open interest every two years, based on the higher 24-month average open interest.[54] However, MFA continues to have concerns that the recalculation will not factor fluctuations based on external factors or the built-in cushion traders implement to ensure that they stay under position limits, which is typically 10 percent or more. As a result, there will be lower open interest when position limits become effective and, because the recalculation looks back at prior open interest levels, the following year's position limits levels may be lower. The ultimate result is a self-reinforcing cycle of lower open interest and lower position limits in successive years.

Finally, we are concerned about the accuracy of the data available to the Commission used to measure open interest of OTC swaps in referenced commodities. The Commission explicitly acknowledges reporting errors: "Several reporting entities have submitted data that contained stark errors. For example, certain reporting entities submitted position sizes that the Commission determined to be 1000 times, or even 10,000 times, too large."[55] Commissioner O'Malia has publicly questioned the integrity of the OTC swap data that is reported to the Commission.[56] In addition, there are serious questions as to whether reporting parties are properly classifying the products for the data that they are reporting.[57] In response to these grave concerns, the Commission has instituted an interdivisional working group to review regulatory

[52] ICE Futures U.S. Product Guide, *available at* https://www.theice.com/productguide/ProductSpec.shtml?specId=6590198.

[53] MFA 2010 Comment Letter at 16; MFA 2011 Comment Letter at 10.

[54] Position Limits for Futures and Swaps, 76 Fed. Reg. at 71,641-42 ("This procedure may provide for limits that would be generally less restrictive than the proposed limits, since, by way of example, a continued decline in open interest over two years under the Proposed Rule would result in a lower limit each year, whereas under the final rule the limit for the first year would not decline and the limit for the second year would be based on the higher 24-month average open interest."); Position Limits for Derivatives, 78 Fed. Reg. at 75,765.

[55] Position Limits for Derivatives, 78 Fed. Reg.at n.428, 75,734.

[56] Dissenting Statement of Commissioner Scott O'Malia, Position Limits for Derivatives, 78 Fed. Reg. at 75,841 ("It is especially troubling that the large trader data being reported under Part 20 of Commission regulations is still unreliable and unsuitable for setting position limit levels, almost two full years after entities began reporting data, and that we are forced to resort to using data from 2011 and 2012 as a poor and inexact substitute." (internal citation omitted).).

[57] Andrew Ackerman, *CFTC Misreporting Size of Swaps Market, Agency Says*, WALL ST. J., Dec. 18, 2013.

swaps data reporting.[58] MFA believes that the result of these data-related concerns, combined with the concerns outlined above, will be position limits that are too low to account for legitimate risk-reducing strategies or liquidity needs. Accordingly, the Commission should delay the position limits rules as they pertain to swaps until the interdivisional working group has received industry feedback on reporting issues and those issues have been resolved, thereby basing position limits for swaps on accurate data.

H. Quotes for Bilaterally-Negotiated OTC Swaps

MFA respectfully recommends that the Commission clarify its policies related to a bid or offer for a contract that, if accepted, would have the result of causing the party making such bid or offer to exceed position limits.[59] In the context of swaps in a referenced commodity, MFA believes that a mere indicative bid or offer or indication of interest for an OTC swap that does not result in a binding transaction should not result in a violation of position limits. MFA believes that the inclusion of indicative bids, offers, or indications of interest in the calculation of position limits could have a significant dampening effect on liquidity if it caused dealers to be unwilling to quote a market. Therefore, the Commission should explicitly provide that an indicative bid or offer for a swap in a referenced commodity will not result in a violation of position limits.

* * * * *

We appreciate the opportunity to offer suggestions to the NPRM. We would be happy to discuss our comments or any other issues raised in the 2013 Position Limits Proposal at greater length with the Commission or its staff. If the staff has any questions, please do not hesitate to contact Jennifer Han or the undersigned at (202) 730-2600.

Respectfully submitted,

/s/ Stuart J. Kaswell

Stuart J. Kaswell
Executive Vice President & Managing Director,
General Counsel

Cc: The Hon. Mark Wetjen, Acting Chairman
The Hon. Scott O'Malia, Commissioner
The Hon. Bart Chilton, Commissioner

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[58] CFTC Press Room, *CFTC to Form an Interdivisional Working Group to Review Regulatory Reporting* (Jan. 21, 2014), *available at* http://www.cftc.gov/PressRoom/PressReleases/pr6837-14.

[59] CME Rule 562, which applies to exchange traded futures contracts, provides that "any person making a bid or offer that would, if accepted, cause such person to exceed the applicable position limits shall be in violation of this rule."

Alternative Investment Management Association

Melissa D. Jurgens
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Commodity Futures Trading Commission
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Submitted via http://comments.cftc.gov

RIN number 3038-AD99

10 February 2014

Dear Ms Jurgens,

Position Limits for Derivatives; Proposed Rule

The Alternative Investment Management Association (**AIMA**)[1] appreciates the opportunity to provide comments on the Commodity Futures Trading Commission's (**the Commission**) proposed rule[2] in respect of Position Limits for Derivatives (**the Position Limits Proposals**).

In parallel with this submission, we are also filing comments in respect of the Commission's proposed rule on aggregation of positions (**the Aggregation Proposals**).[3]

As outlined in our response to the Aggregation Proposals, we note that the Commission has adopted many helpful clarifications to the rules on aggregation, which address a number of the concerns that we have previously expressed.[4] At the same time, we believe there are additional changes that could enhance the aggregation framework, and we comment further on these in our response in respect of the Aggregation Proposals.

Notwithstanding the helpful changes that have been made to the Aggregation Proposals, we continue to have fundamental concerns about the Commission's broader approach to position limits. At this stage, we do not believe that compelling evidence has been put forward to justify the *ex ante* establishment of broadly applicable position limits. Instead, we believe that it would make sense for the Commission to proceed cautiously, monitoring the impact of existing reforms to the commodities derivatives markets, whilst analyzing the enhanced data that is now at its disposal, before committing to a position limits regime. On a practical level, we would also reiterate some of the points that we have previously made[5] regarding the challenges associated with the Commission's approach to position limits:

- The breadth of the framework, which captures not just futures but also ''economically equivalent'' swap contracts, is such that it will inevitably create acute challenges for market participants in terms of determining which of their contracts and positions are relevant from the point of view of the Commission's position limits, particularly given that they will have to make such determinations on a real-time basis. Similar challenges have already been recognised by the Commission when it adopted regulations governing large trader reporting for physical commodity swaps.[6] Accordingly, we believe that further guidance should be developed, in consultation with market participants, in order to make the regime workable. The goal should be to provide a calculation that can be easily monitored by buy-side

1 Founded in 1990, AIMA is the global representative of the hedge fund industry. We represent all practitioners in the alternative investment management industry – including hedge fund managers, fund of hedge funds managers, prime brokers, legal and accounting firms, investors, fund administrators and independent fund directors. Our membership is corporate and comprises over 1,300 firms (with over 7,000 individual contacts) in more than 50 countries. See www.aima.org.
2 Proposed Rule 78 FR75680: 17 CFR Parts 1, 15, 17, et al. Position Limits for Derivatives.
3 Proposed Rule 78 FR68946: 17 CFR Part 150 Aggregation of Positions.
4 Filed with Comment Number 58303.
5 Filed with Comment Numbers 33565 and 50064.
6 76 FR43851 (22 July 2011).

firms and that is suitable for use in automated monitoring programs. This will help to avoid undue costs and burdens being placed on market participants.

- We believe that there is a need to distinguish clearly between cash-settled and physically-settled contracts in designing a positions limits framework, given that cash-settled contracts have a less direct impact on the price of the underlying commodity; we believe that this justifies initially setting limits for cash-settled contracts at a higher level than limits for physically-settled contracts.

- While we support the increased limit for cash-settled contracts under the conditional-spot-month limit, we remain concerned that the restriction on simultaneously holding physically-settled contracts will potentially drive liquidity away from physically-settled contracts.

In a practical sense, an important component of a workable position limits regime is the provision by trading venues of timely, clear and detailed information regarding the limits that apply in respect of contracts traded on those venues. Accordingly, in its supervision of Designated Contract Markets (**DCMs**) and Swap Execution Facilities (**SEFs**), the Commission could look at the nature of information provided to market participants and whether this is sufficient from the point of view of supporting participants' compliance with the rules.

AIMA would, of course, be happy to discuss position limits and aggregation requirements further. Please contact Adam Jacobs or myself on +44 20 7822 8380 if you have any questions.

Yours sincerely,

Jiří Król
Deputy Chief Executive Officer
Head of Government & Regulatory Affairs

sifma®

Invested in America

| asset management group

February 10, 2014
Melissa Jurgens
Secretary
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Re: Notice of Proposed Rulemaking – Position Limits for Derivatives (RIN 3038-AD11)

The Asset Management Group (the "AMG")[1] of the Securities Industry and Financial Markets Association ("SIFMA") appreciates the opportunity to provide the Commodity Futures Trading Commission (the "CFTC" or the "Commission") with our comments and recommendations relating to the Commission's "Position Limits for Derivatives" proposed rules ("2013 NPRM") promulgated under section 4a of the Commodity Exchange Act ("CEA" or the "Act"), as amended by section 737 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"). The AMG recognizes that regulatory action may be appropriate under certain circumstances in order to achieve the goals set forth in the CEA for setting position limits, namely to prevent market manipulation, protect against excessive speculation, ensure sufficient market liquidity for bona fide hedgers, and deter disruption to price discovery, including preventing price discovery from moving to foreign boards of trade ("FBOTs"), but continues to question whether position limits would achieve these goals, particularly as proposed under the 2013 NPRM.

AMG agrees that the Hunt brothers and Amaranth's speculative trading should "inform" a consideration of position limits rulemaking, but finds that many aspects of the Commission's proposal do little to directly address these two actors' manipulative activities while resulting in serious negative consequences for the commodity markets, AMG members, and our "Main Street" customers. We believe that under the CEA, the Commission must find that speculative position limits are "necessary" and "appropriate" and balance several countervailing statutory factors on a contract-by-contract basis before promulgating position limits rules. The Commission has not met these statutory requirements in promulgating the 2013 NPRM. We believe the Commission should therefore withdraw this proposal to make the needed findings. Nevertheless, if the Commission determines to proceed with the proposal, then it can better effectuate the goals of CEA section 4a by making the following changes:

[1] The AMG's members represent U.S. asset management firms whose combined assets under management exceed $20 trillion. The clients of AMG member firms include, among others, registered investment companies, ERISA plans, and state and local government pension funds, many of whom invest in commodity futures, options, and swaps as part of their respective investment strategies.

- modifying the proposed spot-month limits and withdrawing or increasing the non-spot-month position limit levels;
- provide designated contract markets ("DCMs") and swap execution facilities ("SEFs") more discretion with respect to aggregation requirements and other rules related to position limits;
- preserving the risk management exemption from speculative positions consistent with the terms of the CEA, as informed by administrative precedent and legislative history;
- granting counterparties to "commodity index contracts" an exemption for managing price risk associated with "commodity index contract" positions;
- exempting registered investment companies and ERISA accounts from speculative position limits; and
- extending grandfather relief to pre-existing positions.

1. ***Background on the AMG members' interest in speculative position limits regulations.***

The AMG's members represent U.S. asset management firms whose customers include, among others, registered investment companies, private funds, institutional accounts, ERISA plans and state and local government pension funds, many of whom invest in commodity derivatives as part of their investment strategies. Many of the funds and accounts that AMG members manage generally track a commodity index (*e.g.*, the Dow Jones-UBS commodity index). In addition to managing funds that specialize in commodities-related investments, many AMG members manage asset allocation funds that invest in the commodity markets, thereby enabling investors to obtain exposure to an asset class other than equities and bonds within one balanced and diversified portfolio.

Commodities represent a very small portion of assets under management by AMG members. Nevertheless, commodities represent an important asset class to investors. Through these funds and accounts that invest in commodity derivatives, AMG members offer a convenient, well-established mechanism for individuals, pension funds, retirement plans and other investors to diversify their overall investment portfolios with exposure to the commodity markets. Commodity-linked derivatives also allow prudently managed funds and accounts to mitigate economic risk, such as inflation and foreign exchange movements, and increase overall purchasing power.

Accordingly, members of the AMG have a strong interest in the proper functioning of commodity derivatives and commodities markets without undue restriction. The ability of AMG members to provide investor exposure to commodities as an asset class through these funds and accounts will be directly affected by any position limits rules adopted by the Commission. Any rules that are overly restrictive could adversely affect not only AMG members and the "Main Street" investors that invest in the products they manage, but also the U.S. commodity markets generally, potentially impairing price discovery and liquidity, which in turn could result in increased prices for all participants in the commodity derivatives market. In particular, restrictive limits could harm commodity producers and end-users who rely on these funds and accounts to take the other side of risk-reducing trades and provide a stable pool of liquidity. As the Commission determines whether and at what levels to set position limits, the AMG respectfully submits that it consider the important portfolio diversification mechanism that AMG members provide to investors seeking diversified exposure to commodities, and the adverse impact that position limits may have on AMG members and investors that invest in the products they manage.

2. *The Commission should make findings of necessity and appropriateness of its position limits regime based on a fact-intensive, contract-by-contract analysis.*

The Dodd-Frank Act placed several constraints on the Commission's exercise of CEA section 4a(a)(2) authority to impose position limits designed to ensure that position limits are imposed only when "necessary" and "appropriate" and that they strike an optimal balance among a series of factors.[2] With respect to the requirements to impose position limits when they are "necessary" and "appropriate" we refer to, and agree with, the joint International Swaps and Derivatives Association ("ISDA") and SIFMA comment letter submitted on the 2013 NPRM.[3] With respect to the statutory factors, the CEA requires that the Commission address six countervailing factors or goals as it promulgates position limit rules (the "Six Factors").[4] The Commission must strive to meet the "goals" of CEA section 4a(a)(2)(C) by "striv[ing] to ensure" that (Factor 1) "trading on foreign boards of trade in the same commodity will be subject to comparable limits" and that (Factor 2) "any limits to be imposed by the Commission will not cause price discovery in the commodity to shift to trading [to FBOTs]."[5] CEA section 4a(a)(3)(B) directs the Commission to balance four additional factors when exercising its CEA section 4a(a)(2) authority:

- (Factor 3) to diminish, eliminate, or prevent excessive speculation causing sudden or unreasonable fluctuations or unwarranted changes in price;
- (Factor 4) to deter and prevent market manipulation, squeezes, and corners;
- (Factor 5) to ensure sufficient market liquidity for bona fide hedgers; and
- (Factor 6) to ensure that the price discovery function of the underlying market is not disrupted.[6]

In order to establish speculative position limits that address these factors "to the maximum extent practicable," the Commission would need to consider each commodity

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[2] *See also* CEA section 4a(a)(1) and *ISDA v. CFTC*, No. 11-cv-2146 at 15 (D.D.C. Sept. 28, 2012), available at http://www.futuresindustry.org/downloads/USDC-DC_Position-Limits-Rule-Injunction_092812.pdf ("The precise question, therefore, is whether the language of Section [4a(a)(1)] clearly and unambiguously requires the Commission to make a finding of necessity prior to imposing position limits. The answer is yes.").

[3] *See* Letter to CFTC from ISDA and SIFMA Re: Notice of Proposed Rulemaking – Position Limits for Derivatives (RIN 3038-AD99) (Feb. 10, 2014), *available at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=59611&SearchText=.

[4] These Six Factors are separate from any other considerations, including a finding of necessity, required under CEA section 4a(a)(1) or any other consideration included in a finding of appropriateness. The Six Factors provide a purpose for the speculative position limits regime the Commission may impose under CEA section 4a(a)(2).

[5] CEA section 4a(a)(2)(C).

[6] CEA section 4a(a)(3)(B).

individually because the calculus required to fully maximize these factors would differ based on characteristics specific to each commodity contract market, as discussed further below.[7] The requirement to conduct a fact-intensive contract-by-contract analysis of which contracts should be subject to position limits also is supported by administrative precedent.[8] These factors also apply to rules that affect the efficacy of position limits. We believe the Commission must analyze each exercise of discretion it proposes to undertake in establishing position limits under these Six Factors.

2.1. The AMG agrees that the Hunt brothers and Amaranth's speculative trading should "inform" a consideration of position limits.

While the 2013 NPRM proposes to issue position limits rules without a finding of necessity, "in an abundance of caution," it makes a general finding of necessity citing two historic episodes: (1) Hunt brothers (1979-1980) and (2) Amaranth (2006). Amaranth and the Hunt brothers shared one important feature in common: both were "pure speculator[s]"[9] that did not have financial or physical exposures that offset the risk exposures created by their extremely large natural gas or silver derivatives positions (respectively). The Commission claims that these two firms' speculative trading "inform" the Commission's proposal.[10]

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[7] We note that in our interpretation of CEA section 4a(a)(2)'s "as appropriate" language, the Commission must make a fact-driven interpretation that position limits are appropriate and, if so, that the limits it has selected are also appropriate, regardless of whether the Commission must make a finding of necessity before establishing position limits.

[8] In the 2013 NPRM, the Commission cites a rulemaking from 1981 ("1981 Rulemaking") as supporting its assertion that the Commission only has "to determine that excessive speculation is harmful to the market and that limits on speculative positions are a reasonable means of preventing price disruptions in the marketplace that place an undue burden on interstate commerce" to meet the requirements of CEA section 4a(a)(1). 78 Fed. Reg. at 75,683 at fn. 34, *citing* 46 Fed. Reg. at 50,940. The 2013 NPRM ignores, however, that the 1981 Rulemaking imposed speculative position limits only after a fact-intensive inquiry into the characteristics of individual contract markets in order to determine limits "most appropriate" for "an individual contract market." 46 Fed. Reg. at 50,940 ("[CEA section 4a] represents an express Congressional finding that excessive speculation is harmful to the market, and a finding that speculative limits are an effective prophylactic measure." Consistent with this, the Commission promulgated rules directing DCMs to "employ their knowledge of their individual contract markets to propose the position limits they believe most appropriate."). In other words, DCMs' deployment of "knowledge" of an "individual contract market" allowed DCMs to implement position limits "most appropriate" for that market. Furthermore, in the 1981 Rulemaking, the Commission found that specific speculative position limits designed to combat excessive speculation should be carefully calibrated so as not to "interfere with normal trading patterns or significantly impact market liquidity or pricing efficiency… [or] cause [the preponderance] of speculative traders to conduct their trading in a foreign futures market." 46 Fed. Reg. at 50,940-50,941 ("The Commission is aware that speculation is often an important contributing factor to market liquidity and pricing efficiency. […] In this respect, the Commission indicated that in its review of proposed [DCM] speculative limits, it will consider the historical distributions of speculative positions considering, among other things, recent trends in position patterns, the frequency of positions occurring at different levels and the levels at which occur the preponderance of speculative positions normally observed in the market.").

[9] *Id*. at 75,692 at note 103 ("Amaranth was a pure speculator that, for example, could neither make nor take delivery of physical natural gas."). "The Hunt brothers were speculators who neither produced, distributed, processed nor consumed silver." *Id.* at 75,686.

[10] *Id.* at 75,685.

The Hunt brothers exemplify two forms of manipulation: cornering a physical market to benefit a large leveraged derivatives position and the short squeeze.[11] Amaranth is an example of "banging the close" manipulation[12] coupled with "excessive speculation" in the form of large calendar spread speculative positions that, at times, amounted to as much as 40% of all of the open interest on the New York Mercantile Exchange ("NYMEX") for the winter months (October 2006 through March 2007)."[13]

We agree that these two firms' abusive trading could be instructive and provide commenters the ability to compare the Commission's proposal with actual undesirable trading activity (as opposed to theoretical harms addressed by "prophylactic" limits). However, when we compare Amaranth or the Hunt brothers' trading to the 2013 NPRM's provisions, we find that many key aspects of the proposal go far beyond preventing such market abuse while imposing significant, real harm to the commodity and commodity derivatives markets and market participants. This harm is precisely what Congress sought to avoid in requiring the Commission to make a finding of appropriateness in support of position limits, including careful consideration of the Six Factors for each contract subject to position limits. We note, finally, that neither Amaranth nor the Hunt brothers were subject to an existing regulatory regime that aligned their incentives with investors, limited their leverage, required them to diversify their holdings, and required them to provide their investors transparency.

2.2. The Commission already has the power to address the purposes of CEA section 4a without a restrictive position limits regime.

The Commission's exercise of its CEA section 4a authority to impose "necessary" and "appropriate" speculative position limits should take into account its ability to prevent excessive speculation and manipulation in the absence of new speculative position limits. Concerns regarding manipulation and excessive speculation are already addressed through DCMs' and SEFs' position limits and accountability rules.[14] DCMs' (or SEFs') position accountability rules can prevent manipulative or potentially manipulative conduct, or "excessive speculation," far before a position limit is reached while not imposing unneeded constraints on large positions that

[11] "Position limits would help to deter and prevent manipulative corners and squeezes, such as the silver price spike caused by the Hunt brothers and their cohorts in 1979–80." 78 Fed. Reg. at 75,683. The Commission defined both manipulative corners and squeezes: "A market is 'cornered' when an individual or group of individuals acting in concert acquire a controlling or ownership interest in a commodity that is so dominant that the individual or group of individuals can set or manipulate the price of that commodity. In a short squeeze, an excess of demand for a commodity together with a lack of supply for that commodity forces the price of that commodity upward." *Id.* at 75,685.

[12] *CFTC v. Amaranth*, Complaint for Injunctive and Other Equitable Relief under the Commodity Exchange Act, CA 07-CIV-6682, July 25, 2007, available at http://www.cftc.gov/ucm/groups/public/@lrenforcementactions/documents/legalpleading/enfamaranthcomplaint072507.pdf.

[13] Excessive Speculation in the Natural Gas Market, Staff Report, Permanent Subcommittee on Investigations of the Senate Committee on Homeland Security and Governmental Affairs, U.S. Senate, at 6 and 51-52 (June 25, 2007), available at http://www.levin.senate.gov/imo/media/doc/supporting/2007/PSI.Amaranth.063507.pdf ("Amaranth Report").

[14] *Speculative Position Limits-Exemptions From Commission Rule 1.61; Comex Proposed Amendments to Rules 4.47 and 4.48*, 57 Fed. Reg. 29,064, 29,065-29,066 (June 30, 1992). *See also e.g.*, CME Rulebook, Rule 560, available at http://www.cmegroup.com/rulebook/CME/I/5/5.pdf.

pose no risk.[15] Violations of these position limits are violations of federal law under CEA section 4a(e). The Commission also has surveillance capabilities (e.g., large futures and swaps trading reports,[16] swap data reporting and recordkeeping requirements,[17] "special call" authority,[18] etc.) that provide it granular visibility into the commodity derivatives and cash market activities (upon special call) of all market participants to prevent manipulation and detect excessive speculation. This increased visibility is augmented by automated surveillance systems,[19] the Commission's emergency powers under CEA section 8a(9), new Dodd-Frank anti-manipulation and disruptive trade practices authority,[20] and the Commission's whistleblower program – all of which vastly increase the probability of detecting, preventing, and taking effective action against manipulative or potentially disruptive speculative activity.

3. *Comments on specific aspects of the Commission's proposal*

If, notwithstanding our comments above, the Commission adopts speculative position limits, then it should make significant changes to the rulemaking in order to better address the CEA's Six Factors. Below, we provide comments aimed at achieving the goals embodied in CEA section 4a in light of Amaranth and the Hunt brothers. Our suggestions, if implemented, form an alternative to the Commission's proposal that would be less costly in terms of compliance costs, result in less negative consequences on liquidity and price discovery, and provide the same benefit in terms of reduced likelihood for excessive speculation and manipulation.

3.1. The proposed spot-month position limits are inappropriate because they fail to take into account the characteristics of each contract and should therefore be withdrawn or significantly altered.

3.1.1. The Commission's spot-month limit formula is arbitrary and the Commission should adopt an approach that takes into account the characteristics of each commodity market or defer to DCMs and their knowledge of individual markets to determine appropriate spot-month position limit levels.

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15 *See e.g.,* CBOT Rulebook, Rule 560, available at http://www.cmegroup.com/rulebook/CBOT/I/5/5.pdf.

16 *See* 17 CFR parts 15, 16, 17, 18, and 20.

17 *See* 17 CFR part 45.

18 *See e.g.*, 17 CFR 18.05 and 17 CFR 20.6.

19 *See* CFTC Market Surveillance Program, http://www.cftc.gov/IndustryOversight/MarketSurveillance/CFTCMarketSurveillanceProgram/tradepracticesurveillance (last visited Jan. 26, 2013) ("Trade violation detection software will perform sophisticated pattern recognition and data mining to automate basic trade practice surveillance. Among other things, TSS will provide Commission staff with the necessary tools to conduct inter-exchange and cross border surveillance of related contracts; to detect novel and complex abusive practices in today's high-speed, high volume global trading environment; and to perform timely and customized analyses of all trading activity as well as complex, value-added surveillance in significant cases.").

20 *See* CEA section 4c.

The Commission proposes to set spot-month position limits at 25% of estimated deliverable supply under proposed 150.2(e)(3). If a commodity market has consistently liquid cash markets, greater storage capacity, and more reliable supply, it would be unlikely to be subject to a short squeeze or susceptible to cornering, even with position limits set at higher than 25% of estimated deliverable supply.[21] We encourage the Commission to provide a means by which more appropriate spot-month position limit levels may be established. We therefore recommend the Commission either adopt an approach that takes into account the characteristics of each commodity market or, consistent with the terms of CEA section 4a and administrative precedent, that the Commission defer to DCMs and their knowledge of individual markets to determine appropriate spot-month position limit levels.

3.1.2. The Commission's spot-month limit determination process should be explained further in order to avoid arbitrary and potentially harmful outcomes.

Under proposed 150.2(e)(3), DCMs listing physical-delivery referenced contracts would be required to submit, every two years, estimates of deliverable supply. The Commission indicates that it will defer to DCMs' estimate of deliverable supply unless it "determines to rely on its own estimate."[22] The Commission gives no indication as to when or under what standard it will determine to "rely on its own estimate," leaving open the possibility of arbitrary determinations that could be harmful to the markets. We recommend the Commission provide specific criteria both for when it determines not to rely on the DCMs' estimate and as to how it will formulate its own estimates of deliverable supply in such circumstances. We also recommend that the Commission estimates be subject to notice and comment.

3.1.3. Market participants should be permitted to net their cash-settled and physically-settled positions in a spot month in order to accurately reflect their aggregate spot-month positions.

Under proposed 150.2(a), the Commission proposes separate federal physical-delivery spot-month position limits and aggregate cash-settled position limits. The Commission has not demonstrated that these separate limits are necessary. We understand one motivation behind this proposal is a theoretical concern that a market participant could establish an unrestricted long position in the physical-delivery contract held through the end of the spot month resulting in a delivery obligation for its counterparties that is offset with a cash-settled position. Market discipline is generally sufficient to deter such trading behavior. While maintaining the long physical-delivery position could be used to effect a short squeeze, the trader in this scenario would not benefit from any price spike caused by a short squeeze – indeed, their short positions would result in substantial losses. More importantly, the danger to market integrity under this scenario is adequately addressed by DCMs' and futures commission merchants' rules and by procedures designed to ensure that market participants that hold a long or short position into a

[21] *See* 17 CFR 1.61(a)(2)(1991).

[22] 78 Fed. Reg. at 75,728; proposed 150.2(a)(3)(i).

delivery period actually have the ability to take or make delivery.[23] Conversely, allowing market participants to net physically-settled and cash-settled contracts would more accurately reflect net positions. We see no reason why such netting should not be permitted.

3.2. The Commission's non-spot-month limit formula is arbitrary and the Commission should adopt an approach that takes into account the characteristics of each commodity market or defer to DCMs and their knowledge of individual markets to determine appropriate non-spot-month position limit levels.

The Commission proposes under 150.2(e)(4) to use the same formula ("open interest formula") regardless of the characteristics of the market.[24] The Commission first proposed the open interest formula in 1992 for "legacy" agricultural commodities subject to federal speculative position limits.[25] Because the Commission has not undertaken an analysis of the individual referenced contract commodity markets, its proposed non-spot-month position limits would be inappropriate for all referenced contracts. In the same 1992 rulemaking the Commission stated that the "fundamental tenet in the Commission's setting of speculative position limits is that such limits must 'be based upon the individual characteristics of a specific contract market.'"[26] The Commission also noted that "the limits which are appropriate for certain types of commodities, such as agricultural commodities, may [not] be appropriate for other tangible or intangible commodities."[27] The Commission suggested different limits might be appropriate for non-agricultural commodities because of the "depth of the underlying cash market and ease of arbitrage [that] differ from agricultural markets."[28] For example, with respect to energy and metals commodities, the Commission found in 1992 that because these commodities generally exhibited "a high degree of liquidity," position accountability rules – rather than limits - would be adequate to address concerns relating to excessive speculation.[29]

Notwithstanding these countervailing considerations, the Commission now proposes to apply the same open interest formula to all 28 referenced contract commodities. It is unclear how the misgivings the Commission had in 1992 have been overcome. If anything, the agricultural markets now resemble the energy and metals markets of 1992 in terms of greater liquidity, which would provide support for a less restrictive formula under Commission

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[23] *See* e.g., NYMEX Rulebook, Rule 716, available at http://www.cmegroup.com/rulebook/NYMEX/1/7.pdf ("each clearing member shall be responsible for assessing the account owner's ability to make or take delivery for each account on its books with open positions in the expiring contract. Absent satisfactory information from the account owner, the clearing member is responsible for ensuring that the open positions are liquidated in an orderly manner prior to the expiration of trading.").

[24] The formula would set single-month and all-months position limits at 10% of open interest for the first 25,000 contracts in a referenced contract market and 2.5% thereafter. Proposed 150.2(e)(4).

[25] *See* Revision of Federal Speculative Position Limits, Proposed Rules, 57 Fed. Reg. 12,766 (Apr. 13, 1992).

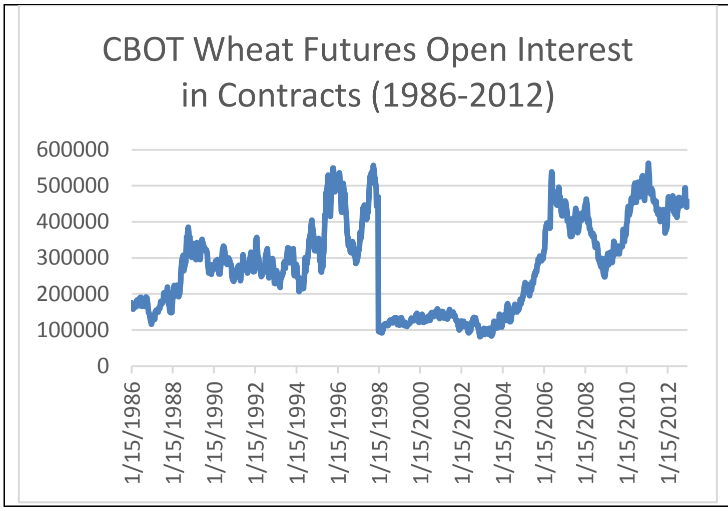
[26] *Id*. at 12,770, *citing* 52 Fed. Reg. at 6,815.

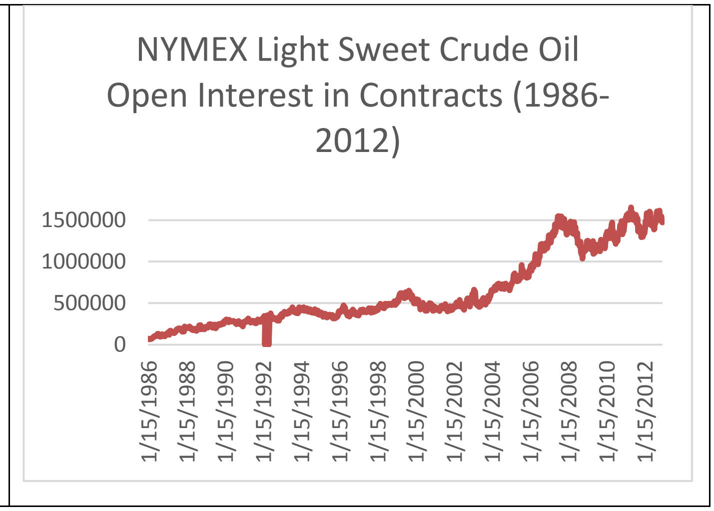
[27] *Id*.

[28] *Id*. at n. 14.

[29] 57 Fed. Reg. at 29,065-29,066 (June 30, 1992) (also finding that speculative position limits are not necessary in commodities that "have substantial forward markets that readily are arbitraged with the futures of [sic] option markets.").

administrative precedent. Take, for example, the following levels of open interest (indicative of liquidity) in the CBOT Wheat and NYMEX Light Sweet Crude Oil futures contracts:[30]





We note further that the Commission's proposed non-spot-month position limit formula results in a disparate impact that demonstrates this formula is wholly inappropriate. The limits the Commission is proposing would have widely different effects on different commodities. For example, Table 11 to the 2013 NPRM shows that in COMEX Copper referenced contracts, 16 unique enterprises would have been over the Commission's speculative position limit levels in 2011-2012. In contrast, in many other referenced contract markets, the number of overages is few. Is this because there is more "excessive speculation" in COMEX Copper than in NYMEX Henry Hub Natural Gas, for example (which Table 11 describes as having zero non-spot-month overages)? It does not attempt to explain that there is any rationale behind this disparate impact. The Commission does not explain whether any, all, or some of the overages it has indicated in Table 11 result from speculative positions or from bona fide hedging positions or from a combination of the two. Essentially, what Table 11 indicates is that the impact of the Commission's non-spot-month position limits is random – demonstrating that the non-spot-month formula and the limits that result from it are entirely arbitrary and have no relationship to preventing excessive speculation or manipulation. If the Commission is to set non-spot-month limits at arbitrary levels, it should do so at very high levels in order to prevent the types of harms unduly restrictive position limits can have, as reflected in the statutory Six Factors.

Finally, the Commission's proposed non-spot-month position limits do not increase the likelihood of preventing the excessive speculation or manipulative trading exemplified by Amaranth or the Hunt brothers relative to the status quo. We note that the large non-spot-month positions of Amaranth and the Hunt brothers could have been addressed by DCMs and SEFs under position accountability rules.[31] In the case of Amaranth, NYMEX did, in fact, cap

[30] Data taken from the CFTC's Historical Compressed Commitment of Traders Report, http://www.cftc.gov/MarketReports/CommitmentsofTraders/HistoricalCompressed/index.htm (last visited Jan. 26, 2014).

[31] CEA sections 5(d)(5)(A) and 5h(f)(6)(A) ("To reduce the potential threat of market manipulation or congestion, especially during trading in the delivery month," a DCM or SEF shall adopt for each contract, "as is necessary and appropriate, position limitations or position accountability for speculators.").

Amaranth's speculative positions on its exchange. Amaranth responded by taking advantage of a regulatory arbitrage opportunity: "[i]n August 2006, Amaranth traded natural gas on [the then unregulated InterContinental Exchange ("ICE") OTC platform] rather than NYMEX so that it could trade without any restrictions on the size of its positions."[32] The Amaranth Report recommended therefore, most pertinently, that: (1) the Congress should give the Commission authority to regulate electronic OTC markets (e.g., ICE at the time)[33] and (2) the Commission "should monitor aggregate positions on NYMEX and ICE for all of the months in which contracts are traded, not just for contracts near expiration."[34] This concern from 2006 would not exist under today's rules. Under the Commission's part 37 rules relating to SEFs it now has authority over all multilateral derivatives trading platforms (ICE would have been a SEF) and the Commission's expanded part 20 and its part 45 reporting rules now enable it to monitor all futures and swaps positions. Notably, the Amaranth Report did not recommend that the Commission establish non-spot-month position limits for natural gas, the 28 referenced contract commodities, or all physical commodity derivatives.

In order to ensure that the Commission's speculative position limits "to the maximum extent practicable" achieve the goals of CEA section 4a, AMG recommends therefore that the Commission take one of three non-exclusive actions: (1) decline to adopt non-spot-month position limits; (2) set non-spot month limits at levels where they are unlikely to affect any persons until the Commission is able to develop a factual record to justify restrictive limit levels under the Six Factors and other purposes of CEA section 4a; or (3) re-propose its speculative position limits proposal after utilizing the expertise and resources of DCMs and SEFs to determine "appropriate" non-spot-month position limit levels as the Commission has done traditionally.[35]

3.3 DCMs and SEFs should be given more discretion to determine appropriate aggregation and other requirements relating to speculative position limits.

The 2013 NPRM proposes to limit the discretion of DCMs and SEFs ("exchanges" collectively) in their administration of speculative position limits in two important ways including:

(1) under proposed 150.5(a)(5), aggregation requirements must "conform to" those of the Commission under proposed 150.4; and

[32] Amaranth Report at 6.

[33] *Id*. at 8.

[34] *Id*. Significantly, the Amaranth Report did not recommend changes to the Commission's position limits regime. Its recommendation that the Amaranth problem be addressed, in part, by statutory authority for the Commission to regulate electronic OTC markets was achieved through the enactment in 2008 of the Food, Conservation and Energy Act of 2008, Public Law 110-246, 122 Stat. 1624 (June 18, 2008).

[35] In 1981, the Commission finalized rules directing DCMs to "employ their knowledge of their individual contract markets to propose the position limits they believe most appropriate." Establishment of Speculative Position Limits, 46 Fed. Reg. 50,938, 50,940. In other words, DCMs' deployment of "knowledge" of an "individual contract market" enabled DCMs to implement position limits "most appropriate" for that market. *Id.* The Commission also stated that it "endorse[d]" the "concept" that "the exchanges are in the best position to determine the most efficacious level at which position limitations may be established." *Id*. at n. 5. *See also* 17 CFR 1.61(a)(2) (1981).

(2) under proposed 150.5(a)(2)(i), limiting their discretion to defining the scope of hedge and other exemptions to those that conform to the Commission's definitions.

As discussed above, the Commission has traditionally followed the principle that exchanges have superior knowledge of individual contract markets enabling them to implement position limits and related aggregation requirements and exemptions "most appropriate" for that market.[36] Consistent with this principle, we urge the Commission to provide exchanges broader discretion in determining aggregation rules and exemptions, subject to Commission oversight. Providing the exchanges this broader discretion would enable them to more effectively and efficiently further the purposes of CEA section 4a by tailoring these requirements to the individual commodity contract markets. The need for broader exchange discretion is particularly warranted in the non-referenced contracts, including excluded commodities, that the Commission has not considered in any depth in this rulemaking. We note finally that the Commission has not considered the costs borne by exchanges and market participants from the prescriptive approach to exchange-administered position limits, including exchange aggregation notice filing and application requirements conforming to proposed 150.4(c)(1) and (c)(2). For example, under proposed 150.4(c), the Commission would require notice and application filings for market participants seeking an aggregation exemption. The Commission should allow and encourage exchanges to tailor such requests for aggregation relief to the markets they regulate.[37]

3.4 Bona fide hedging exemption.

3.4.1. The Commission should preserve the risk management exemption.

Commission staff historically provided a bona fide hedging exemption for positions that offset risks related to swaps or similar OTC positions involving both individual commodities and commodity indexes ("risk management exemption").[38] These exemptions were subject to specific conditions to protect the market, including: (1) the futures positions must offset specific price risk; (2) the dollar value of the futures positions must be no greater than the dollar value of the underlying risk; and (3) the futures positions must not be carried into the spot month.[39]

[36] In 1981, the Commission finalized rules directing DCMs to "employ their knowledge of their individual contract markets to propose the position limits they believe most appropriate." 46 Fed. Reg. at 50,940. This included aggregation and exemption rules. *See* 17 CFR 1.61 (1982).

[37] AMG is commenting separately on the Commission's aggregation proposal, Aggregation of Positions, 78 Fed. Reg. 68,946 (Nov.15, 2013).

[38] "Position Limits and the Hedge Exemption, Brief Legislative History," Testimony of General Counsel Dan M. Berkovitz, Commodity Futures Trading Commission, July 28, 2009, available at http://www.cftc.gov/PressRoom/SpeechesTestimony/berkovitzstatement072809.

[39] *Id. See also* CFTC Form 40, Part B, Item 3 and Schedule 1 (defining "hedging" as including "asset/liability risk management, security portfolio risk, etc.").

The Commission proposes to eliminate the risk management exemption on the basis of CEA section 4a(c)(2)'s definition of a "bona fide hedging transaction or position" ("statutory definition"), which was added by Dodd-Frank. CEA section 4a(c)(2) was modeled on 17 CFR 1.3(z) ("regulatory definition") with one important difference: the statutory definition of a "bona fide hedging transaction or position" did not include the term "normally" in presenting the "temporary substitute criterion," which provides that a bona fide hedge position should "normally represent[] a substitute for transactions made or to be made or positions taken or to be taken at a later time in a physical marketing channel." (emphasis added) The Commission proposes to interpret this omission as meaning that a bona fide hedging position must represent a "substitute for transactions made or to be made in a physical marketing channel."[40] In other words, the hedge position is "a temporary substitute for a cash transaction that will occur later."[41]

By eliminating the risk management exemption, the Commission's speculative position limits rules would go beyond deterring excessive speculation and manipulation and would have the effect of deterring and constraining liquidity by market participants with non-speculative positions in commodity derivatives – essentially deterring non-speculative, prudent risk management. Commodity funds and asset allocation funds, for example, utilize commodity derivatives in active or passive management strategies in order to provide diversified, commodity-based returns to their clients and to mitigate economic risk. Reduced liquidity would also result in increased prices for all participants in the commodity derivatives market.

We urge the Commission to reconsider eliminating the risk management exemption. A risk management position represents a non-speculative, flat-risk position and should therefore be exempt from speculative position limits. The risk management exemption also encourages the provision of liquidity across financial and physical markets and therefore furthers the goals of promoting liquidity for bona fide hedgers and price discovery. We note that neither Amaranth nor the Hunt brothers used the risk management exemption and therefore its elimination is not warranted if those two actors' trading activity is to provide any guidance to the Commission as to the regulatory changes that it should implement. Indeed, speculative position limits under CEA section 4a are intended to target excessive speculation and manipulation,[42]and risk management positions present zero risk of either. As discussed below, we do not believe the elimination of the risk management is compelled by CEA section 4a(c)(2) and the Commission has ample authority to exempt risk management positions under CEA section 4a(a)(7).

3.4.1.1. The Commission has ample authority under CEA section 4a(a)(7) to exempt risk management positions.

Representative Lucas, the Ranking Member of the House Agriculture Committee that authored CEA section 4a(c)(2)'s bona fide hedging language strongly cautioned against overly

[40] 78 Fed. Reg. at 75,709.

[41] *Id.* at 75,686 at fn. 70.

[42] CEA section 4a(a)(1). CEA sections 4a(a)(4) and 4a(a)(5) provide further evidence that Congress wanted to ensure that market participants could net price risk in related products, "significant price discovery function" and "economically equivalent" swaps, with futures price risk.

strict position limits with overly narrow exemptions.[43] Representative Lucas urged the Commission to "make use of the exemptive authority granted by the [CEA] to avoid establishing position limits which would force widely-held funds or firms to divest their current holdings in highly regulated products."[44] Congress did not intend, he continued, that the Commission establish speculative position limits in a manner that "impair[s] price discovery for commercial producers and their counterparties, and cause unnecessary harm to the futures markets and small investors."[45]

Under CEA section 4a(a)(7), the Commission may exempt any persons or transactions from position limits. Proposed 150.3(e)(2) provides that the Commission "may request" relief from the Commission for "risk-reducing practices commonly used in the market." The Commission does not explain specifically under what circumstances this relief may be granted.

We believe the Commission should provide for a means to obtain reliable and predictable relief for risk management positions under the Commission's CEA section 4a(a)(7) authority. The Commission should provide for a risk management position exemption under the conditions of the Commission's past risk management exemption, i.e., (1) the exempted positions must offset specific price risk; (2) the dollar value of the futures positions must be no greater than the dollar value of the underlying risk; and (3) the futures positions must not be carried into the spot month. These conditions ensure the exemption would not be abused. The Commission could grant such relief in a manner similar to the bona fide hedging exemption in proposed 150.3(a)(1)(i).

3.4.1.2. Eliminating the risk management exemption is not compelled by CEA section 4a(c)(2).

The Commission's rationale in proposing to eliminate the risk management exemption is based on the omission of a single word in CEA section 4a(c)(2)'s "bona fide hedging transaction or position" definition. We urge the Commission to reconsider its interpretation of the omission of the term "normally" in CEA section 4a(c)(2)'s temporary substitute clause and to interpret that clause as it has been traditionally interpreted under applicable administrative precedent: as a non-restrictive condition providing further indication that the risks being hedged under the exemption arise from operation of a commercial enterprise.

In the Commission's 1987 "Clarification of Certain Aspects of the Hedging Definition," ("1987 Clarification"), the Commission provided background on the meaning of the temporary substitute criterion of 17 CFR 1.3(z).[46] In the 1987 Clarification, the Commission pointed out

[43] Letter dated December 16, 2010 from Congressman Spencer Bachus and Congressman Frank Lucas to the Honorable Timothy Geithner, the Honorable Gary Gensler, et al. (the "Bachus/Lucas Letter"), available at http://online.wsj.com/public/resources/documents/bachus.pdf ("Overly prescriptive position limits would drain existing liquidity from the capital markets, impair price discovery for commercial producers and their counterparties, and cause unnecessary harm to the futures markets and small investors.").

[44] *Id*.

[45] *Id*.

[46] Clarification of Certain Aspects of the Hedging Definition, 52 Fed. Reg. 27,195, 27,196 (July 20, 1987).

that in first proposing a definition of bona fide hedging position in 1977, the Commission did not include the term "normally."[47] The Commission added the term "normally" in response to commenters to "provide *further* indication" that the temporary substitute criterion was *not* to be "construed as a restrictive, *necessary condition* for the bona fide hedging" exemption (emphasis added). In 1977, the Commission explained that the intention behind the proposed definition of bona fide hedging position was "to set out the basic conditions which must be met by a bona fide hedging transaction or position; i.e. that it must be economically appropriate to risk reduction, such risks must arise from operation of a commercial enterprise, and the price risk fluctuations of the futures contract used in the transaction must be substantially related to fluctuations of the cash market value of the assets, liabilities, or services being hedged."[48] The Commission has not, until 2011, intended to make the temporary substitute criterion a necessary requirement for the bona fide hedging exemption.

Similarly, in its 1987 "Guidelines for Risk Management Exemptions," the Commission noted that the concerns it sought to address with speculative position limits related primarily to "derivative market positions lacking an offsetting cash or derivative market position." For market participants claiming a risk management exemption, they have an offsetting derivatives position and should be able to claim an exemption for managing these risks.

3.5 The AMG welcomes exclusion of "commodity index contracts" but recommends that counterparties to "commodity index contracts" be provided an exemption for managing commodity index contract position risks.

3.5.1. "Commodity index contract" exclusion.

We welcome the exclusion of "commodity index contracts"[49] from the proposed definition of "referenced contract." We agree with the Commission's rationale for this exclusion. Commodity index contracts do not "involve a separate and distinct exposure to the price of a referenced [] contract's commodity" price.[50] This provision benefits many asset managers and their customers who invest in such products in order to gain price exposure to a diversified array of commodities over a diverse set of maturities. The liquidity added to commodity markets by these investments is particularly beneficial in longer dated maturities where liquidity can be scarce. Commercial, bona fide hedgers that might use long-dated commodity derivatives can more cost-effectively establish long-term hedges because of the liquidity that commodity index contracts provide.

3.5.2. The Commission should provide a risk management exemption for positions hedging the price risk of "commodity index contracts."

[47] *Id*. citing 42 Fed. Reg. at 14,833.

[48] *Id*.

[49] "Commodity index contract means an agreement, contract, or transaction that is not a basis or any type of spread contract, based on an index comprised of prices of commodities that are not the same or substantially the same." Proposed 150.1.

[50] Federal Speculative Position Limits for Referenced Energy Contracts and Associated Regulations, 75 Fed. Reg. 4,144, 4,153 (Jan. 26, 2010).

As discussed above in section 3.4, we urge the Commission to reinterpret its bona fide hedging exemption to include risk management positions, inclusive of price risk associated with commodity index contract positions. If it declines to do so, we urge the Commission to extend a risk management exemption for the limited purpose of managing the price risk associated with commodity index contract positions, consistent with the intention behind excluding commodity index contract positions. We note that currently, counterparties to commodity index swaps can remain in compliance for exceeding a position limit based on a position hedging "commodity index contract" price risk under DCM risk management exemptions. We believe that counterparties to commodity index swaps should be able to manage the risk of these contracts without these positions counting against their limits.

3.5.3. Benefits arising from commodity index investment and the costs borne by deterring commodity index investment.

AMG believes that evidence supports the many benefits offered to commodity markets by commodity index funds and accounts, whose long-term diversified investments enhance stability, price discovery and producer hedging. Recognizing these benefits, Senator Blanche Lincoln stated in a July 16, 2010 Senate Colloquy that commodity index participation, in addition to the benefits it provides investors, may "also serve to provide agricultural and other commodity contracts with the necessary liquidity to assist in price discovery and hedging for the commercial users of such contracts."[51]

These considerable benefits will be significantly reduced if the Commission determines not to grant the relief we have requested. Our members noted that leading up to the effective date of the Commission's vacated part 151 position limits rules (a rulemaking that also excluded "commodity index contracts" and also did not provide for an exemption for positions offsetting commodity index contract price risk), our members noticed less liquidity and noticeably worse pricing for commodity index swaps. These results were due to the expectation of counterparties that our members trade with that their ability to manage the risk offsetting commodity index swaps would be hindered under the anticipated part 151 rules. Our members would expect to incur similar costs under the Commission's new proposed rules. Furthermore, during the run-up to the effective date of the Commission's vacated part 151 position limits rules, our members were finding that they needed to transact with additional counterparties in order to trade commodity index swaps as their counterparties were concerned with hitting limits. As a result, many of our members were preparing to initiate trades with less creditworthy counterparties in order to source liquidity.

We note finally that neither Amaranth nor the Hunt brothers were in any way involved in commodity index swaps. Reducing the ability of commodity index swap counterparties to

[51] Blanche Lincoln, Senate Colloquies, July 16, 2010: "I wish to also point out that section 719 of the conference report calls for a study of position limits to be undertaken by the CFTC. In conducting that study, it is my expectation that the CFTC will address the soundness of prudential investing by pension funds, index funds and other institutional investors in unleveraged indices of commodities that may also serve to provide agricultural and other commodity contracts with the necessary liquidity to assist in price discovery and hedging for the commercial users of such contracts."

manage the risk associated with their swap positions therefore would present no beneficial effect on the Commission's ability to prevent the type of trading conducted by these two bad actors.

3.6. The Commission should exempt registered investment companies and ERISA accounts from speculative position limits.

Registered investment companies ("RICs") and ERISA accounts are subject to stringent regulatory requirements that ensure that the incentives of the investment adviser are aligned with those of the customers.[52] These rules and regulations ensure that RICs and ERISA accounts do not engage in the kind of "excessive speculation" or manipulative trading exemplified by Amaranth or the Hunt brothers. Unlike RICs and ERISA accounts, Amaranth was an unregulated private fund.[53] Amaranth had a leverage ratio that ranged from five to eight times capital, which resulted in more market pressure when Amaranth was forced to unwind positions.[54] Being unregulated, Amaranth's investors had little transparency in how dangerously exposed Amaranth was to natural gas prices.[55] Not subject to diversification requirements, Amaranth had extreme exposures to just a few natural gas settlement prices.[56]

In contrast to Amaranth and the Hunt brothers, RICs and ERISA accounts are subject to existing regulatory regimes that align their incentives with investors, limit their leverage, require them to diversify their holdings, and require them to provide transparency to their investors. RICs are required to comply with all regulations and related guidance under the Investment Company Act of 1940 (the "Investment Company Act"), including those regarding counterparty limits, liquidity and asset coverage and the use of leverage. The Investment Company Act limits the amount of leverage that a RIC may obtain, including through the use of derivatives, by requiring the fund to segregate liquid assets or hold offsetting positions on its books in an equivalent amount.[57] Unleveraged funds significantly reduce market pressure in the event of any forced unwinding of positions, and are substantially less likely to liquidate due to market movements than leveraged funds like Amaranth.

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[52] *See* letter dated December 16, 2010 from Congressman Spencer Bachus and Congressman Frank Lucas to the Honorable Timothy Geithner, the Honorable Gary Gensler, et al. (the "Bachus/Lucas Letter"), available at http://online.wsj.com/public/resources/documents/bachus.pdf ("We hope that the [CFTC] will make use of the exemptive authority granted by the [CEA] to avoid establishing position limits which would force widely-held funds or firms to divest their current holdings in highly regulated products. Overly prescriptive position limits would drain existing liquidity from the capital markets, impair price discovery for commercial producers and their counterparties, and cause unnecessary harm to the futures markets and small investors.").

[53] Amaranth Report at 57.

[54] *Id.* at 58.

[55] *See* The Amaranth Debacle: A Failure of Risk Measures or a Failure of Risk Management?, Ludwig B. Chincarini, Journal of Alternative Investment (2007), available at http:// pages.pomona.edu/~lbc04747/pubs/pub10.pdf.

[56] *See e.g.,* Amaranth Report at 60-64.

[57] Section 18(f) of the Investment Company Act; *see also* Securities Trading Practices of Registered Investment Companies, Investment Company Act Release No. 10666 (Apr. 18, 1979); Merrill Lynch Asset Management, L.P., SEC No-Action Letter (July 2, 1992); Dreyfus Strategic Investing & Dreyfus Strategic Income, SEC No-Action Letter (June 22, 1987).

RICs electing to be "diversified companies" under the Investment Company Act are required to follow strict diversification requirements, including restrictions against investing more than 5% of total capital in any single issuer, and requirements to invest at least 75% of total assets in cash and securities.[58] In addition, RICs must maintain at least 85% of their assets as liquid investments, are required to calculate and publish net asset values and disclose substantial information about their investments, and are obligated to maintain comprehensive compliance programs. All of these requirements help assure that RICs do not engage in manipulative practices, become too heavily concentrated in any one investment, or create systemic risk.

Additionally, under Subchapter M of the Internal Revenue Code of 1986, at least 90% of the annual gross income of a RIC must be so-called "qualifying income" in order for the RIC to maintain its tax status as a "regulated investment company." Commodities and derivatives referencing commodities generally do not produce qualifying income under current law. As a result, some RICs use wholly-owned unregistered subsidiaries to invest in commodity derivatives transactions; each subsidiary is included within the regulatory limitations applicable to its registered parent.[59] Nevertheless, any RIC's investment in such a subsidiary, and therefore its investment in commodities or commodity-related instruments, is limited to no more than 25% of a RIC's assets under the tax diversification provisions of the Internal Revenue Code.[60]

Investment advisers to ERISA accounts are subject to strict fiduciary obligations, including the duty to discharge their duties under a stringent prudence test,[61] the duty to diversify the investment of an account's assets so as to minimize the risk of large losses[62] and the duty of loyalty, which requires each adviser to discharge its duties solely in the interest of the account and for the exclusive purpose of providing benefits to participants and beneficiaries.[63] Similarly, the Investment Company Act requires advisers to RICs and other vehicles to be registered

[58] Section 5 of the Investment Company Act.

[59] Mutual funds utilizing this parent-subsidiary structure rely on IRS private letter rulings which conclude that income arising from a mutual fund's investment in a subsidiary that invests in commodities investments constitutes qualifying income. These same private letter rulings require such subsidiaries to comply with the requirements of Section 18(f) of the Investment Company Act and all related guidance regarding asset coverage and the use of leverage by mutual funds. *See, e.g.,* I.R.S. Priv. Ltr. Rul. 201039002 (June 22, 2010); I.R.S. Priv. Ltr. Rul. 201037012 (June 4, 2010); I.R.S. Priv. Ltr. Rul. 201030004 (Apr. 28, 2010). In addition, in various SEC No-Action Letters, the SEC has permitted RICs to establish wholly-owned foreign subsidiaries for the purpose of avoiding unfavorable foreign tax treatment or foreign investment restrictions, and has acknowledged that such subsidiaries did not avoid any regulatory requirements since the parent-subsidiary structures were operated in accordance with the Investment Company Act. *See, e.g.,* S. Asia Portfolio, SEC No-Action Letter (Mar. 12, 1997), Templeton Vietnam Opportunities Fund, Inc., SEC No-Action Letter (Sept. 10, 1996), The Spain Fund, Inc., SEC No-Action Letter (Mar. 28, 1988) and The Scandinavia Fund, Inc., SEC No-Action Letter (Nov. 24, 1986).

[60] Section 851(b)(3) of the Internal Revenue Code.

[61] ERISA § 404(A)(1)(B), 29 U.S.C.A. § 1104(A)(1)(B). This provision requires the manager to have conducted a sufficient investigation into the details and particulars of a transaction and its appropriateness for the account involved prior to engaging in a transaction.

[62] ERISA § 404(A)(1)(C), 29 U.S.C.A. § 1104(A)(1)(C).

[63] ERISA § 404(A)(1)(A), 29 U.S.C.A. § 1104(A)(1)(A).

themselves under the Investment Advisers Act of 1940, which subjects advisers to rigorous fiduciary duties of loyalty and care to customers as a matter of law.[64]

While RICs and ERISA accounts present virtually no risk of "excessive speculation" or manipulation, their unfettered participation in commodity markets provides valuable liquidity, particularly in long-dated maturities, that is beneficial to bona fide hedgers with long-term hedging needs. We therefore urge the Commission to exempt RICs and ERISA accounts from position limits, particularly where the risk of "excessive speculation" and manipulation is non-existent. Granting these exemptions would reduce the compliance cost associated with RIC and ERISA participation in commodity markets without any real reduction in the efficacy of position limits.

3.7. Grandfather relief.

3.7.1. Grandfather relief should not be limited to only those who do not increase their position after the effective date of a limit.

The Commission proposes at 150.2(f)(2) to exempt a referenced contract position ("a pre-existing position") acquired by a person in good faith prior to the effective date of a non-spot-month limit, on the condition that the position is not increased after the effective date of a limit. This latter condition should be eliminated because in many scenarios it appears to be inconsistent with the purposes of CEA sections 4a(b)(2) and 4a(c)(1).

CEA section 4a(b)(2) provides that position limits "shall not apply to a position acquired in good faith prior to the effective date of such rule, regulation, or order." CEA section 4a(c)(1) provides that "[n]o rule, regulation, or order issued under subsection (a) of this section shall apply to transactions or positions which are shown to be bona fide hedging transactions or positions as such terms shall be defined by the Commission by rule, regulation, or order consistent with the purposes of this chapter."

Consistent with these statutory directives, we believe that the Commission should exempt all pre-existing positions established in good faith from position limits, particularly those that are pre-existing bona fide hedging positions. Doing so should not undermine the Commission's ability to prevent another Amaranth or Hunt brothers.

3.7.2. The Commission should amend proposed 150.2 to provide for grandfather relief for positions that result from rolling forward of pre-existing positions.

AMG members' counterparties often hedge the risk of commodity derivatives positions by holding positions in futures contracts. In order for them to effectively hedge the risk associated with a pre-existing position, they would need to be able to roll these hedges from a prompt month into a deferred contract month. The Commission should therefore amend proposed 150.2(f)(2) to cover "any commodity derivative contract position ***or position that***

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[64] *See* Sections 206(1) and (2) of the Advisers Act; *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 192-93 (1963).

<u>results from transferring the price risk exposure created by such position into a deferred contract month</u> acquired in good faith…"

3.7.3. The costs associated with the Commission's narrow grandfather relief are significant.

Absent the changes we have requested above, particularly in sections 3.4.1, 3.5.1, and 3.5.2, AMG members and their customers would bear significant costs resulting from a diminished ability of AMG members to generate desired returns for customers. Without these changes, the rules as proposed would also result in diminished willingness from our counterparties to transact, resulting in unduly higher costs to enter into commodity derivatives trades. Indeed, as indicated above, AMG members witnessed a noticeable widening of the bid/ask spread, indicative of reduced liquidity, in the commodity index swaps market even before the Commission's vacated part 151 position limits rules were to take effect in 2012, which was due in part to a similarly narrow grandfather exemption under vacated 151.9.

4. *Conclusion*

As discussed above, the AMG believes that before imposing speculative position limits, the Commission must and should make fact-intensive findings of necessity and appropriateness in support of its position limits regime based on an individual contract-by-contract basis. As the Commission has failed to do so with the 2013 NPRM, we believe that it should be withdrawn. Nevertheless, if the Commission determines to proceed with this rulemaking, the Commission can better effectuate the goals of CEA section 4a by making the following changes:

- modifying the proposed spot-month limits and withdrawing or increasing the non-spot-month position limit levels;
- providing DCMs and SEFs more discretion with respect to aggregation requirements and other rules related to position limits;
- preserving the risk management exemption from speculative position limits consistent with the terms of the statute, as informed by administrative precedent and legislative history;
- granting counterparties to "commodity index contracts" an exemption for managing commodity index contract position risks;
- exempting RICs and ERISA accounts from speculative position limits; and
- expanding grandfather relief available to pre-existing positions.

* * *

The AMG thanks the CFTC for the opportunity to comment on the proposed rulemaking concerning position limits. The AMG would welcome the opportunity to further discuss our comments with you. Should you have any questions, please do not hesitate to contact Matt Nevins at 212-313-1176 or Michael Loesch at 202-662-4552.

Sincerely,

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August 1, 2014

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Re: Notice of Proposed Rulemaking – Aggregation of Positions (RIN 3038-AD82)

The Asset Management Group ("AMG")[1] of the Securities Industry and Financial Markets Association ("SIFMA") appreciates the opportunity to provide the Commodity Futures Trading Commission (the "Commission") with supplemental comments regarding the "Aggregation of Positions" proposed rulemaking ("2013 Aggregation NPRM").[2] As asset managers, AMG members have a significant interest and unique perspective in the Commission's proposed aggregation requirements for purposes of applying speculative position limit rules. We appreciate the opportunity to have participated in the Aggregation Panel at the staff's public Roundtable on position limits for physical commodity derivatives held on June 19, 2014 (the "Roundtable").

We are writing this supplemental comment letter to provide further detail on some of the questions that were raised during the Aggregation Panel of the Roundtable[3] and to recap briefly the main concerns expressed by AMG during the Roundtable and in our initial comment letter on the 2013 Aggregation NPRM.[4]

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[1] The AMG's members represent U.S. asset management firms whose combined assets under management exceed $30 trillion. The clients of AMG member firms include, among others, registered investment companies, ERISA plans, and state and local government pension funds, many of whom invest in commodity futures, options, and swaps as part of their respective investment strategies.

[2] *Aggregation of Positions*, 78 Fed. Reg. 68,946 (Nov. 15, 2013).

[3] At the Roundtable, questions were asked of the Aggregation Panel as to: 1) how to reconcile the notion of basing position aggregation on control of trading rather than ownership with the relevant statutory text; and 2) how other regulations that use ownership as an indicia of control are distinguishable from position limits aggregation. We address both these questions in this letter.

[4] A copy of AMG's initial comment letter on the 2013 Aggregation NPRM, filed on February 10, 2014 ("Initial Aggregation Letter"), is enclosed for convenience.

1. Owned Entity Aggregation Should Only Apply Where There is Trading Control

1.1. Interest of Asset Managers in the Proposed Owned Entity Aggregation Rules.

Asset managers often put on commodity derivative positions directly for the funds and accounts that they manage. Asset managers also acquire equity interests in operating companies for the funds and accounts that they manage. Those operating companies also may use commodity derivatives, but the fund or account investing in the equity of the operating company, and its asset manager, typically will not have control over the commodity derivatives positions held by the operating company. While asset management companies would not generally need to aggregate customer positions managed by independent account controllers under the independent account controller ("IAC") exemption, it alone is not sufficient to assuage the concerns of AMG members with respect to the 2013 Aggregation NPRM, particularly with regard to its owned entity provisions. Individual asset managers may find it difficult to avail themselves of the IAC exemption for commodity derivatives positions held by owned entities where a fund or account that it manages has beneficial equity ownership of 10% or more. Accordingly, the owned entity aggregation requirement (and its exemptions) are vitally important to AMG members.

AMG firmly believes that aggregation should not be mandated where an asset manager, or the fund or account that it manages, is a passive investor and does not have trading control over the commodity derivatives positions of the underlying operating company in which the fund or account invests. During the Roundtable, several panelists echoed that point.

1.2. Aggregation Based on Ownership Rather than Control Is Not Required or Authorized by the CEA.

The owned entity aggregation requirement in the 2013 Aggregation NPRM is based on the view that the language of Section 4a of the CEA "requires aggregation on the basis of *either ownership or control of an entity*."[5] More specifically, the 2013 Aggregation NPRM reads the "ownership clause" of CEA Section 4a(a)(1) to permit ownership of another entity, standing alone, to serve as a separate and distinct basis to require aggregation of positions held by that owned entity, regardless of actual control of such trading accounts.[6]

As discussed in AMG's Initial Aggregation Letter, however, a close reading of the statutory text reveals that aggregation must be based on control (and not ownership alone).[7]

[5] 78 Fed. Reg. at 68,956 (emphasis added).

[6] *Id., citing* 77 Fed. Reg. at 31,773.

[7] We note that the revised staff questions posted on the Commission's website in connection with the Roundtable stated that "Section 4a(a)(1) of the CEA requires aggregation of an entity's positions on the basis of either ownership or control of the entity . . .". *See Position Limits Roundtable: Revised Staff Questions* at 6 n.9, available at http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/staffquestions061214.pdf. For the reasons discussed in text, we believe that this statement is not consistent with the correct reading of the statutory text.

Consequently, we believe that the proposed owned entity aggregation requirement of the 2013 Aggregation NPRM would exceed the Commission's authority under the CEA.[8]

The relevant portion of CEA Section 4a(a)(1) reads as follows:

> [T]he positions held and trading done by *any persons directly or indirectly controlled by such person* shall be included with the positions held and trading done by such person. . .[9]

In the first clause quoted above, the phrase "any persons" refers to third parties, whereas the phrase "such person" refers to the "investor" subject to this statutory aggregation provision. In other words, the positions held and trading done by a third party (*i.e.*, the controlled entity) which are directly or indirectly controlled by the investor shall be included with the positions held and trading done by the investor. The second clause quoted above, which is the "ownership clause" relied on by the 2013 Aggregation NPRM and which reads "positions held and trading done by such person" (*e.g.*, the investor), actually applies to positions "held" (*i.e.*, owned) and trading done (*i.e.*, performed) by the investor (and not to positions held by the controlled entity).

On its face, CEA Section 4a(a)(1), requires aggregation of positions held and trading done by third parties only when the third party's positions and trading are "*directly or indirectly controlled*." The statute specifically addresses the conditions under which a third party's positions are to be aggregated. CEA Section 4a(a)(1) does not provide for aggregation when the positions are held by a third party that is owned, but not controlled, or leave open room for inferring an "ownership aggregation" requirement by the Commission.[10]

In sum, the Commission should eliminate the owned entity aggregation requirement from any final rule as it is not authorized by the statute. By doing so, the Commission would: 1) properly limit aggregation of an owned entity's positions to the situation provided for in CEA Section 4a(a)(1), namely, where there is control of those positions; and 2) properly limit the ownership clause of CEA Section 4a(a)(1) to positions owned by the investor, not an owned entity.

1.3 Positions Held by an Owned Operating Company are Distinguishable from Positions Held in an Owned Trading Account.

Aggregation of positions held by an operating company in which an entity invests should not be required where that entity does not have actual trading control over the commodity derivatives positions held or trading done by such operating company. For example, in the asset

[8] *See* AMG Initial Aggregation Letter at 7-8.

[9] 7 U.S.C. 6a(a)(1) (emphasis added).

[10] The legislative history of the CEA is consistent with this point. A 1968 Senate Report provides that "Section 2 of the bill amends section 4a(1) of the [CEA] to show clearly the authority to impose limits on […] trading done and positions held by a person controlled by another shall be considered as done or held by" a person (e.g., the investor). S. Rep No. 947, 90th Cong., 2 Sess. 5 (1968).

management context, commodity derivatives positions held and controlled by an operating company in which an investment fund or institutional account invests should not be aggregated with the positions controlled by the fund or account or its asset manager.

The Commission historically has interpreted "accounts" for aggregation purposes to encompass accounts owned by third parties that are commonly owned, but not commonly controlled.[11] All of the Commission's pre-2011 position aggregation rulemakings required aggregation on the basis of direct ownership in accounts, not ownership interests in third parties that, in turn, own positions in derivatives trading accounts.[12]

We believe that it is worth reiterating the practical difficulties that would be imposed on asset managers if they were required to aggregate positions held by operating companies in which the funds or accounts that they manage invest. Asset managers would need to monitor the equity ownership held by the funds and accounts that they manage for this purpose, and would need to develop some system of monitoring commodity derivatives positions held by these operating companies. Moreover, operating companies may not be willing to divulge their commodity derivatives positions to asset managers of funds or accounts that invest in these entities, and even if they would be willing, the information may not be made available on a timely basis. These challenges alone render aggregation on the basis of equity ownership in operating companies an unworkable policy.

1.4. Unlike Other, Unrelated Regulations, Ownership is Not an Appropriate Indicia of Control for Purposes of Aggregation of Commodity Derivatives Positions.

The appropriateness of basing an agency rule on an ownership threshold depends on the purpose of the particular rule at issue.[13] With respect to certain rules, including antitrust, securities, and Federal Energy and Regulatory Commission ("FERC") rules, equity ownership is relevant to rules that relate to corporate control. Conversely, equity ownership is not an appropriate indicia of control for purposes of requiring aggregation of commodity derivatives positions for speculative position limits; rules adopted in the context of corporate control are of

[11] *See, e.g.*, the Commission's 1979 Statement of Aggregation Policy, which is squarely focused on ownership of accounts, not ownership in entities that own accounts. Its first point stated that "[e]xcept for a limited partner or shareholder (other than a commodity pool operator) in a commodity pool, any person who has a 10 percent or more financial interest in an account will be considered as an account owner." Statement of Policy on Aggregation of Accounts and Adoption of Related Reporting Rules, 44 Fed. Reg. 33,839 (Jun. 13, 1979).

[12] AMG's Initial Aggregation Letter detailed how the owned entity aggregation requirement in the 2013 Aggregation NPRM also is inconsistent with: 1) the legislative history of CEA Section 4a; 2) the Commission's historical approach to aggregation for position limit purposes; 3) other Commission rules; and 4) even the Commission's enforcement history. *See* AMG Initial Aggregation Letter at 8-11.

[13] The Commission and the Securities and Exchange Commission ("SEC") made this point in their joint "Entity Definitions Rulemaking." *See Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant,"* 77 Fed. Reg. 30,596 (May 23, 2012).

limited relevance for this purpose. As discussed above, the statutory text of CEA Section 4a(a)(1) is consistent with this view as it authorizes aggregation only where an investor *controls the trading* that occurs in an owned entity's accounts.[14]

By contrast, for example, the antitrust provisions cited in the 2013 Aggregation NPRM address when companies must file a pre-merger notification with federal regulators under the Hart–Scott–Rodino Antitrust Improvements Act. This requirement seems logical given that equity ownership is indicative of control with respect to acquisitions and size of the market. The SEC uses ownership percentages for various purposes, including requiring disclosures of information, reporting and determining the existence of restricted or control securities, but not for limiting speculative trading activity with respect to derivatives or securities within its jurisdiction. FERC's rules regulating public utility holding companies and electric power market participants address size of the market and not the type of concerns about controlling trading activity at issue in the CFTC's aggregation rulemaking.

The purpose of the Commission's aggregation rules is to help prevent coordinated trading that could yield the type of excessive speculation or manipulative activity that position limits are designed to address. Passive investors of the type managed by AMG members – even where their ownership interest exceeds 50% – simply do not have control over the commodity derivatives trading decisions of owned operating companies that would raise the specter of coordinated trading activity.[15] Conflating equity ownership with trading control in these circumstances would be misguided.[16]

2. Recap of Other Key Points from AMG's Initial Comment Letter

In addition to our views on owned entity aggregation expressed above, we would like to reiterate the following fundamental points that were expressed in further detail in our Initial Aggregation Letter and at the Roundtable:

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[14] *See also* AMG's Initial Aggregation Letter at 11-12 (detailing how the Commission traditionally has interpreted "control" in CEA Section 4a(a)(1) and its predecessors as control of trading, not corporate control).

[15] Under some circumstances, when a passive investor (for example, an ERISA plan) makes an investment in an entity, the investor's fiduciary duties (for example, as created under ERISA) could entail making prudent inquiries into the trading activities and investments of the owned entity. *See Harley v. Minnesota, Mining and Manufacturing Co*., 898 F. Supp. 2d 898, 906 (D. Minn. 1999) ('[A] fiduciary is required to undertake an independent investigation into the merits of an investment and to use appropriate, prudent methods in conducting the investigation."), *aff'd*, 284 F.3d 901 (8th Cir. 2002), *cert. denied,* 537 U.S. 1106 (2003); 29 CFR 2550.404a-1(b)(2) (providing that an investment fiduciary, when evaluating an investment, must take into consideration the risk of loss associated with the investment). This fiduciary duty to prudently inquire falls far short of coordinated trading activity.

[16] During the Aggregation Panel at the Roundtable, representatives of both CME Group and ICE explained that they use ownership as an indicia of control in performing their market surveillance function. This may be appropriate. But the use of ownership by market surveillance staff of an exchange (or the Commission) to identify situations warranting closer review, in order to determine whether coordinated trading in fact may be taking place, is far different than *requiring* aggregation of positions of owned entities, based solely on ownership of that entity, in determining whether a trader has exceeded speculative position limits.

- ***Aggregation of Investments in Accounts or Pools with "Substantially Identical Trading Strategies" Should Not be Required, Particularly where there is an Independent Account Controller***. The Commission should not adopt the requirement in proposed rule 150.4(a)(2) to aggregate investments in funds that follow "substantially identical trading strategies" regardless of common trading control, significant ownership, or even knowledge of the relevant investments. This is particularly the case in situations where the accounts or pools with "substantially identical trading strategies" have independent account controllers; where independent entities control the trading for these strategies, these positions should not be aggregated. Any contrary result would have a disparate, unjustified effect on fund-of-fund managers that invest in multiple funds employing the same or similar commodity strategy, even if the positions in those funds are controlled by independent fund managers. Further, this could run counter to other regulatory requirements, such as those applicable to investment companies registered with the SEC.[17] (See AMG's Initial Aggregation Letter at pps. 13-14.)

- ***The Independent Account Controller Exemption Should Not be Limited by CPO/CTA Registration Status*****.** The Commission should extend "independent account controller" eligibility to registered commodity pool operators ("CPOs"), exempt and excluded CPOs, and exempt and excluded commodity trading advisors ("CTAs"). In addition, the burdensome requirement on asset managers to submit notice filings to claim the independent account controller exemption should be eliminated. (See AMG's Initial Aggregation Letter at p. 15.)

- ***Any Procedures Adopted to Perfect Exemptions Should be Simplified***. While we strongly believe that the Commission should forgo an owned entity aggregation requirement in any final rulemaking, if the Commission proceeds with such a requirement, we believe that the exemptions proposed in the 2013 Aggregation NPRM should be substantially liberalized. Specifically, we believe that any proposed requirements that investors ensure that the entities in which they invest maintain written procedures, that financials are not consolidated, or that directors make certifications should be eliminated. Similarly, we recommend eliminating any notice filing requirements for the owned entity exemption, or at the very least, allowing use of a simplified, generic omnibus filing.[18] (See AMG's Initial Aggregation Letter at pps. 4-7, 15).

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[17] *See, e.g.,* Section 12(d)(A)(1) of the Investment Company Act of 1940 and the rules promulgated thereunder, which impose limits on the amount of investments that a registered investment fund may make in any other registered investment company; this requirement could cause a registered fund-of-funds to invest in multiple funds with substantially identical trading strategies.

[18] This recommendation with respect to filing requirements applies to both an owned entity aggregation exemption, to the extent owned entity aggregation remains part of any final rule, and the independent account controller exemption.

- ***Passive Investors in Rule 4.13 Exempt Pool Aggregation Requirement.*** The Commission should revise proposed rule 150.4(b)(1)(iii) to require passive investors to aggregate positions of a Rule 4.13 exempt pool based on a 25% or more ownership interest only when "the operator of which is exempt from registration *under §§ 4.13(a)(1) or (a)(2).*" This revision is appropriate in order for the requirement to apply to its intended targets. (See AMG's Initial Aggregation Letter at p. 13.)

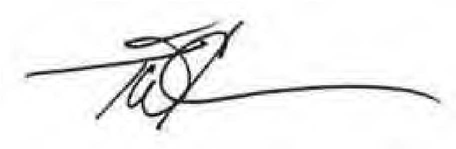
3. Summary

For the reasons stated above, AMG recommends that the Commission not adopt the proposed owned entity aggregation rules as proposed in the 2013 Aggregation NPRM. Instead, the rules should be revised as discussed above in order to address their impact on passive investors that have no control over, or even knowledge of, the specific commodity derivatives trading activities of owned entities in which they have invested.

* * *

We appreciate your consideration of our comments. We stand ready to provide any additional information or assistance that the Commission might find useful. Should you have any questions, please do not hesitate to contact Matt Nevins at 212-313-1176 or Terry Arbit at Norton Rose Fulbright at 202-662-0223.

Sincerely,



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Enclosures: AMG Initial Comment Letter Regarding Notice of Proposed Rulemaking – Aggregation of Positions (RIN 3038-AD82)

cc (w/encl): Timothy G. Massad, Chairman
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Sharon Y. Bowen, Commissioner
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Re: Notice of Proposed Rulemaking – Aggregation of Positions (RIN 3038-AD82)

The Asset Management Group ("AMG")[1] of the Securities Industry and Financial Markets Association ("SIFMA") appreciates the opportunity to provide the Commodity Futures Trading Commission (the "Commission") with comments regarding the "Aggregation of Positions" proposed rulemaking ("2013 Aggregation NPRM").[2] We believe that the Commission has made some positive steps in this 2013 Aggregation NPRM, but we have some significant concerns with respect to certain aspects of the proposal, in the following areas in particular:

- ***Owned Entity Aggregation.*** The Commission should not adopt the owned entity aggregation as proposed. Requiring passive investors, which include, without limitation, registered and private commodity pools and other investment vehicles, pension funds and other institutional clients of asset managers, that have no control over, or even knowledge of, the specific commodity derivatives trading activities of owned entities they have invested in to aggregate the positions of such entities would impose significant costs that would unnecessarily diminish their ability to provide valuable capital investment and generate returns for their beneficiaries and participants, exceeds the scope of the Commission's position aggregation authority under the Commodity Exchange Act ("CEA"), and is an unwarranted departure from the Commission's historical aggregation approach. The proposed exemptions from this owned entity aggregation requirement under proposed rules 150.4(b)(2) (10 to 50% ownership) and (b)(3) (above 50% ownership) do not sufficiently address the flaws of the proposed approach to aggregating owned entity positions in the passive investment ownership context.

[1] The AMG's members represent U.S. asset management firms whose combined assets under management exceed $20 trillion. The clients of AMG member firms include, among others, registered investment companies, ERISA plans, and state and local government pension funds, many of whom invest in commodity futures, options, and swaps as part of their respective investment strategies.

[2] 78 Fed. Reg. 68,946 (Nov. 15, 2013).

- ***Investment in Accounts or Pools with "Substantially Identical Trading Strategies."*** The Commission should not adopt the aggregation requirement in proposed 150.4(a)(2) for investments in funds that follow "substantially identical trading strategies" regardless of common trading control, significant ownership, or even knowledge of the relevant investments. This proposal is vague and lacks sufficient statutory, policy, and cost-benefit rationale.

- ***Passive Investors in Commission Regulation 4.13 Exempt Pool Aggregation Requirement.*** We recommend that the Commission amend 150.4(b)(1)(iii) to only require passive investors to aggregate positions of a Commission regulation 4.13 exempt pool based on a 25% or more ownership interest when "the operator of which is exempt from registration *under §§ 4.13(a)(1) or (a)(2)*" in order for this requirement to apply to its intended targets.

- ***Independent Account Controller Exemption.*** We recommend that the Commission extend "independent account controller" eligibility to registered commodity pool operators ("CPOs"), exempt CPOs, and exempt and excluded commodity trading advisors ("CTAs"). We also question the utility of the burdensome requirement on asset managers to submit notice filings to claim the independent account controller exemption.

1. Owned Entity Aggregation

Consistent with current 17 CFR 150.4(a), under proposed 150.4(a)(1), a person would be required to aggregate "positions in accounts" in which the person "directly or indirectly" has more than a 10% ownership interest. The Commission further proposes to interpret "accounts or positions" to include "accounts or positions" of third party[3] owned entities.[4] The Commission interprets ownership of another entity, standing alone, as providing a separate and distinct basis to require aggregation of the positions owned by the owned entity, regardless of actual control of such trading accounts.[5] That is, the Commission interprets the "ownership prong" of CEA section 4a(a)(1) to apply to accounts owned by owned entities if a person has an ownership interest greater than 10% in that owned entity (and otherwise does not have trading control or have a direct ownership interest in the owned entity accounts themselves).[6]

[3] We use the term "third party" to refer to any person that is separate from another person. A person can have relationships with many types of third parties, e.g., an owned entity, an entity it does not have an ownership interest in but whose trading it controls, etc.

[4] *See* proposed 150.4(b)(2) (providing for an exemption from aggregation requirements for positions in accounts of an owned entity when the ownership interest in the owned entity is between 10 and 50% of total equity). *See also* 78 Fed. Reg. at 68,959.

[5] *Id.* citing 77 Fed. Reg. at 31,773.

[6] *Id.* ("The Commission continues to believe, as stated in the Part 151 Aggregation Proposal, that an equity or ownership interest above 50% constitutes a majority ownership or equity interest of the owned entity and is so significant as to justify aggregation under the ownership prong of Section 4a(a)(1) of the CEA.")

For the reasons set forth below, we recommend that the Commission reconsider its proposed owned entity aggregation rules. We present our specific recommendations in section 1.3 below.

1.1. Requiring passive investors that have no control over, or even knowledge of, the specific commodity derivatives trading activities of owned entities to aggregate the positions of such entities will be unduly costly.

While asset management companies would not generally need to aggregate customer positions managed by independent account controllers under proposed 150.4(b)(5)'s independent account controller ("IAC") exemption, individual IAC or non-IAC asset managers often invest customer assets (either directly or through investment vehicles) in entities that trade in commodity derivatives. Under the Commission's proposed 150.4(a), 10% or more ownership in a trading account may be sufficient to warrant aggregation. In this case, under the Commission's interpretation of the term "account,"[7] a purely passive holder of equity securities would be required to aggregate the positions of all entities of which it has beneficial equity ownership of 10% or more, unless it perfects an exemption to owned entity aggregation (most pertinently under proposed 150.4(b)(2) or (b)(3)). An arbitrary owned entity aggregation threshold at 10% ownership is vastly over-inclusive even if it is used as indicia of corporate control;[8] the Commission itself points out that corporate "control" is imputed at 50% or more ownership for the purpose of pre-merger notifications to federal regulators under the Hart–Scott–Rodino Antitrust Improvements Act.[9]

Passive investors of the type managed by AMG members do not have control over owned entities by virtue of their *passive* ownership interest in a legal entity. As such, they would typically only have minimal knowledge of these owned entities' trading positions and decisions.[10] The 2013 Aggregation NPRM would create a new standard of care for passive investors: they would have to determine whether and to what extent the owned entity (and all of its owned entity affiliates) trade in commodity derivatives and if so, act to perfect an exemption. If no exemption is available, then the passive investor would have to obtain reliable commodity

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[7] We believe this reading would constitute an unexplained change from Commission administrative precedent. *See* section 1.4 below.

[8] As discussed below in section 1.7, the appropriate control standard under Commission position limits rules relates to trading control, not corporate control.

[9] 78 Fed. Reg. at 68,958, *citing* 16 CFR 801.1(b).

[10] Under some circumstances, when a passive investor (for example an Employee Retirement Income Security Act ("ERISA") plan) makes an investment in an entity, the investor's fiduciary duties (for example, as created under ERISA) could very well entail making prudent inquiries into the trading activities and investments of the owned entity. *See Harley v. Minnesota, Mining and Manufacturing Co*., 898 F. Supp. 2d 898, 906 (D. Minn. 1999) ('[A] fiduciary is required to undertake an independent investigation into the merits of an investment and to use appropriate, prudent methods in conducting the investigation."), *aff'd,* 284 F.3d 901 (8th Cir. 2002), *cert. denied*, 537 U.S. 1106 (2003); 29 CFR § 2550.404a-1(b)(2) (providing that an investment fiduciary, when evaluating an investment, must take into consideration the risk of loss associated with the investment).

derivatives position information from the entities in which it invests and is required to aggregate in order to ensure compliance with speculative position limits. In addition, these passive investors would have to develop, often from scratch, costly position monitoring infrastructure and hire or train staff to apply that infrastructure to the derivatives positions of their investments in order to ensure compliance with position limits. These costs to passive investors would deter investment in businesses that own commodity positions and are not offset by any commensurate benefit, especially in terms of reduced likelihood of excessive speculation or manipulation.

1.2. The proposed owned entity aggregation exemptions provide inadequate relief for passive investors and do nothing to further the goals Congress directed the Commission to achieve in promulgating position limits.

The Commission proposes two exemptions to the proposed general rule that requires a person to aggregate accounts owned by a third-party entity where such person has a greater than 10% ownership in the owned entity:

1. Under proposed 150.4(b)(2), the Commission proposes an aggregation exemption for ownership interests of up to 50% of an entity's equity under certain conditions. The owner and the owned entity ("Related Entities") must not have knowledge of one another's trading decisions and have in place protections to ensure independence, including: (1) enforced written procedures to prevent sharing of trading information; (2) physical separations; (3) separately developed and independent trading systems; (4) no sharing of employees that control trading decisions; and (5) no sharing of risk management systems that permit sharing of trading information or strategies before a trade is made. This exemption is effective upon submission of a notice filing under proposed 150.4(c)(1).

2. Under proposed 150.4(b)(3), the Commission proposes an aggregation exemption for ownership interests above 50% ownership under certain conditions. These conditions include all of those described above for ownership interests at and below 50% ownership, plus: (1) certification that the Related Entities' financial results are not consolidated in a financial statement pursuant to relevant accounting rules; (2) each director for the owned entity certifies that (a) all of the owned entity's positions are bona fide hedging positions, or (b) the owned entity's positions do not exceed 20% of any position limit. This exemption must be approved by the Commission or staff operating under delegated authority in order to become effective under proposed 150.4(c)(2).

These two exemptions would provide inadequate relief for passive investors and would do nothing to further the goals Congress directed the Commission to achieve in promulgating position limits.

First, while a move in the right direction, the proposed 150.4(b)(2) exemption from aggregation for ownership interests of up to 50% in the owned entity does not extend to all ownership interests and would require a burdensome notice filing in all investment circumstances, regardless of the absence of common trading control, for no apparent benefit. By

contrast, passive investors in a pool that are not affiliated with the pool operator under proposed 150.4(b)(1) would not be required to submit a notice filing to disaggregate the positions of pools in which they have invested, regardless of their ownership interest in the pool. Again, the 2013 Aggregation NPRM provides no reason why passive investors in owned entities should not have at least the same degree of deference.

Second, the proposed application-based exemption from aggregation in 150.4(b)(3) for ownership interests in excess of 50% is, as a practical matter, unworkable. Passive investors cannot plan their investment and compliance programs around a disaggregation application filing that depends on Commission approval which, even if granted, may take weeks or months to issue, while their managers may need to make immediate investment decisions.

Moreover, the conditions imposed on the proposed 150.4(b)(3) exemption seriously constrain its utility. This is particularly true of the condition prohibiting consolidation of financial results. The fact that an investor consolidates the financial results of the firms in which it invests is not indicative of trading control; earning returns on an investment is the main reason an investor invests. In addition, the requirement that the owned entity's positions not exceed 20% of any position limit effectively subjects owned entities to lower position limits.[11] The 2013 Aggregation NPRM makes no findings that this restriction furthers any of the goals Congress directed the Commission to achieve in promulgating position limits rules under CEA sections 4a(a)(2)(C) and 4a(a)(3)(B).

1.3. The Commission should reconsider its owned entity aggregation requirements.

For reasons stated in more detail in section 1.4 below, we believe the Commission's proposed owned entity aggregation requirements are legally flawed and based on an erroneous interpretation of the CEA and applicable administrative precedent. We recommend, therefore, that the Commission re-examine the 2013 Aggregation NPRM and substantially amend the proposed 150.4(b)(2) and (3) exemptions to achieve a more appropriate balance among the six statutory factors that the CEA requires the Commission to address when promulgating any position limit rules,[12] by:

[11] The alternative requirement that all of the owned entity's positions be bona fide hedging positions is not an independent condition. CEA section 4a(c)(1) prohibits the Commission from restricting the bona fide hedging positions of any trader: "No rule, regulation, or order issued under subsection (a) of this section shall apply to transactions or positions which are shown to be bona fide hedging transactions[.]" CEA section 4a(c)(1). Therefore, the limitation that an owned entity's positions be limited entirely to bona fide hedging positions is simply a sub-set of the requirement that would restrict speculative positions up to 20% of any limit.

[12] These factors include the "goals" stated in CEA section 4a(a)(2)(C), i.e., "striv[ing] to ensure" that (Factor 1) "trading on foreign boards of trade in the same commodity will be subject to comparable limits" and (Factor 2) "that any limits to be imposed by the Commission will not cause price discovery in the commodity to shift to trading [to FBOTs]." They also include the four additional factors that CEA section 4a(a)(3)(B) directs the Commission to balance when exercising its CEA section 4a(a)(2) authority: (1) (Factor 3) to diminish, eliminate, or prevent excessive speculation causing sudden or unreasonable fluctuations or unwarranted changes in price; (2) (Factor 4) to deter and prevent market manipulation, squeezes, and corners; (3) (Factor 5) to ensure sufficient market liquidity for bona fide hedgers; and (4) (Factor 6) to ensure that the price discovery function of the underlying market is not disrupted.

1. Extending the relief provided to passive investors in commodity pools under current 150.4(c) and proposed 150.4(b)(1) to passive investors in owned entities that do not have actual trading control of the owned entity's derivatives trading; and

2. Extending the owned entity exemption at proposed 150.4(b)(2) to include all third party ownership interests (greater than 50%) that do not involve actual common trading control.

In addition, we recommend three additional, non-exclusive changes that would reduce the cost to comply without forgoing meaningful regulatory benefit under the six statutory factors referenced above:

Filing requirements: The Commission should only require a 150.4(c)(1) notice filing when there is majority ownership in addition to indicia of trading control, e.g., a common business purpose relating to derivatives trading or the commercial use of commodities. The Commission's proposed 150.4(c)(2) application procedure should be omitted altogether or reserved for instances where there is majority ownership in addition to a trading control. In any event, a passive investor that holds an equity investment of any amount in an operating company that it has no trading control over should not be required to make any type of filing. If the Commission insists on a filing requirement for passive investors, then it should allow for a simplified, generic omnibus filing that would provide the Commission with notice that a passive investor intends to use the exemption on a going-forward basis consistent with the terms of the exemption for its passive equity investments.

Pro rata attribution of positions: The Commission should allow for the *pro rata* attribution of positions based on ownership interest. *Pro rata* allocation of positions would be less costly for passive investors because it would provide them some proportionate degree of protection if their owned entity exceeds a position limit. For example, for a passive investor with a 15% ownership interest in an owned entity that exceeds a position limit, an allocation of 15% or even 25% of that owned entity's positions would reduce the risk of an inadvertent position limits overage. Accordingly, we recommend *pro rata* allocation of ownership interests within set bands of ownership percentages.

Quarterly measurement: The costs of complying with the Commission's proposed aggregation rules would also be reduced if the Commission provided a safe harbor to passive investors to measure ownership interests on a predetermined basis, such as on quarterly dates. Permitting passive investors to measure ownership interests on a fixed and workable schedule will not undermine the Commission's position limits regime. This approach would mitigate our members' concerns about disruptions to their clients' investments that could otherwise result from frequent changes in ownership interests.

These recommendations would present substantially reduced costs for AMG members and their clients yet would still ensure at least the same degree of efficacy of the Commission's position limits regime under the goals provided by Congress in CEA sections 4a(a)(2)(C) and 4a(a)(3)(B) by providing passive investors with legal certainty that would promote liquidity in

commodity derivatives. In fact, the Commission's proposal would increase the potential for coordinated manipulative trading activity because it mandates common trading control where none currently exists.

1.4. Requiring passive investors that have no control over, or knowledge of, the specific commodity derivatives trading activities of owned entities they have invested in to aggregate the positions of such entities has not been justified.

1.4.1. Requiring passive investors that have no control over, or knowledge of, the specific commodity derivatives trading activities of owned entities they have invested in to aggregate the positions of such entities exceeds the scope of the Commission's position aggregation authority under the CEA.

The 2013 Aggregation NPRM states its basis for requiring the aggregation of owned entity positions regardless of the existence of common trading control as follows (emphasis added):

> In light of the language in section 4a, its legislative history, subsequent regulatory developments, and the Commission's historical practices in this regard, the Commission continues to believe that section 4a requires aggregation on the basis of *either ownership or control of an entity*.[13]

The relevant portion of CEA section 4a(a)(1) provides (emphasis added):

> [T]he positions held and trading done by *any persons directly or indirectly controlled by such person* shall be included with the positions held and trading done by such person; and further, such limits upon positions and trading shall apply to positions held by, and trading done by, two or more persons acting pursuant to an expressed or implied agreement or understanding, the same as if the positions were held by, or the trading were done by, a single person.

CEA section 4a(a)(1), by its terms, requires aggregation of positions held and trading done by third parties only when the other person is "*directly or indirectly controlled*."[14] This is not a situation where the CEA is silent about aggregating the positions of third parties (including owned entities) so that the Commission might fill the gap by inferring that the "ownership prong" applies to positions held by an owned third party; rather, the statute specifically addresses the conditions under which a third party's positions are to be aggregated, i.e., when the positions

[13] 78 Fed. Reg. at 68,956.

[14] In the first critical clause quoted above, the phrase "any person" refers to a third party, whereas the phrase "such person" refers to the principal person subject to this statutory aggregation provision. Thus, re-phrasing the clause slightly for purposes of clarification, the positions held and trading done by a third party (e.g., the company in which an investor invests) directly or indirectly controlled by a person (e.g., the investor) shall be included with the positions held and trading done by that person (e.g., the investor). By contrast, the "ownership prong" that appears immediately after this first clause applies only to directly held positions ("positions held and trading done by such person," e.g., the investor).

held and trading done by the third party are "directly or indirectly controlled." With respect to positions held and trading done by third parties, CEA section 4a(a)(1) imposes a constraint on the Commission's authority to require aggregation. CEA section 4a(a)(1) provides that the aggregation of positions held and trading done by third parties is to occur only when the positions held and trading done by the third party are "directly or indirectly controlled" ("Third Party Aggregation Constraint").

The statutory Third Party Aggregation Constraint is consistent with the legislative history of CEA section 4a. As cited in the Commission's 2012 "Aggregation, Position Limits for Futures and Swaps" proposed rulemaking,[15] a 1968 Senate Report provides that "Section 2 of the bill amends section 4a(1) of the [CEA] to show clearly the authority to impose limits on […] trading done and positions held by *a person controlled by another* shall be considered as done or held by" a person (e.g., the investor).[16]

1.4.2. Requiring passive investors that have no control over, or knowledge of, the specific commodity derivatives trading activities of owned entities they have invested in to aggregate the positions of such entities is an unwarranted departure from the Commission's historical aggregation approach.

The Commission interprets 17 CFR 150.4(b) and proposed Commission regulation 150.4(a) as requiring the aggregation of owned entity positions.[17] The Commission, however, has never promulgated rules (that were not vacated) in which it has interpreted "accounts" to encompass accounts owned by third parties that are commonly owned but not commonly controlled. All of the Commission's pre-2011 position aggregation rulemakings required aggregation on the basis of direct ownership in accounts, not ownership interests in third parties who, in turn, own positions in derivatives trading accounts.

For example, the Commission's 1979 Statement of Aggregation Policy is squarely focused on ownership of accounts, not ownership in entities that own accounts.[18] Its first point stated that "[e]xcept for a limited partner or shareholder in a commodity pool, any person who has a 10% or more financial interest *in an account* will be considered as an account controller" (emphasis added).[19] The 1979 Statement of Aggregation Policy defines "discretionary account" as "a commodity futures trading account for which buying and/or selling orders can be placed or originated, or for which transactions can be effected…"[20]

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[15] 77 Fed. Reg. 31,767 (May 30, 2012).

[16] *Id.* at 31,772 at fn. 80, citing S. Rep No. 947, 90th Cong., 2 Sess. 5 (1968) (emphasis added).

[17] Proposed 150.4(a) ("For the purpose of applying the position limits set forth in § 150.2, unless an exemption set forth in paragraph (b) of this section applies, all positions in accounts for which any person, by power of attorney or otherwise, directly or indirectly controls trading or holds a 10% or greater ownership or equity interest, must be aggregated with the positions held and trading done by such person.").

[18] Statement of Policy on Aggregation of Accounts and Adoption of Related Reporting Rules, 44 Fed. Reg. 33,839 (Jun. 13, 1979).

[19] *Id.* at 33,845.

[20] *Id.*

The 2013 Aggregation NPRM presents the following quote from a position limits rulemaking from 1999 in an attempt to support its interpretation that CEA section 4a(a)(1)'s "ownership prong" includes ownership of third parties' accounts: "the Commission . . . interprets the 'held or controlled' criteria [of CEA section 4a] as applying separately to ownership of positions or to control of trading decisions."[21] However, this quote does not refer to accounts of owned entities. This is not surprising as, again, this 1999 rulemaking was squarely focused on the aggregation of directly owned accounts – and not of accounts owned by an owned third party. For example, the 1999 rulemaking provided that when a person "holds or has a financial interest in or controls more than one account, all such accounts shall be considered by the futures commission merchant, clearing member or foreign broker as a single account…"[22] Thus, neither the quote nor the rulemaking from 1999 support the interpretation in the 2013 Aggregation NPRM.

Contrary to the assertion of the 2013 Aggregation NPRM, the Commission has in fact clearly distinguished between ownership of accounts, on the one hand, and ownership in third party entities that themselves own accounts, on the other. In the context of its CFTC Form 40 rules at 17 CFR 18.04(a)(8), the Commission requires the reporting of information relating to "persons… who have a financial interest of 10% or more in the [Form 40] reporting trader *or* the accounts of the reporting trader" (emphasis added). If financial interests in "accounts" encompassed financial interests in accounts of other persons, then the Commission would have had no need to separately articulate the requirement to report financial interests in the accounts of a reporting trader and the requirement to report financial interests in the reporting trader itself.

The Commission's historical definition of "account" in the position aggregation context is consistent with other Commission regulations that also similarly define the term "account." For example, 17 CFR 39.2 defines "customer account" as meaning "a clearing member account held on behalf of customers, as that term is defined in this section, and which is subject to section 4d(a) or section 4d(f) of the [CEA]" and "house account" as meaning "a clearing member account which is not subject to section 4d(a) or 4d(f) of the [CEA]." 17 CFR 1.3(vv) defines "futures account" to mean an "account that is maintained in accordance with the segregation requirements of sections 4d(a) and 4d(b) of the [CEA] and the rules thereunder." None of these regulations define an "account" as encompassing accounts of owned entities.

The one exception is the Commission's definition of "proprietary account" in 17 CFR 1.3(y),[23] which is defined explicitly to include accounts held by "business affiliates."[24] This term

[21] 78 Fed. Reg. at 68,956, *quoting* Revision of Federal Speculative Position Limits and Associated Rules, 64 Fed. Reg. 24,038, 24,044 (May 5, 1999).

[22] *Id.* at 24,046.

[23] 17 CFR 1.3(y) "*Proprietary account*. This term means a commodity futures, commodity option, or swap trading account carried on the books and records of an individual, a partnership, corporation or other type of association: (1) for one of the following persons, or (2) of which ten percent or more is owned by one of the following persons, or an aggregate of ten percent or more of which is owned by more than one of the following persons:

[...]

is cited as support for the Commission's new interpretation of the term "account" in the position limits context.[25] The term "proprietary account," however, is irrelevant to the position limits context. The term "proprietary account" is used in 17 CFR 155.3, which requires that a futures commission merchant ("FCM") give priority to executing customer orders over orders from any "proprietary account." Moreover, the fact that the term "proprietary account" is explicitly defined to include accounts held by "business affiliates" suggests that in the Commission's regulations, the term "account," standing alone, does not include accounts of owned entities but rather refers only to directly held or controlled trading accounts.

Even the Commission's enforcement history reflects that it has traditionally viewed aggregation of owned entity positions as only being required where there is common derivatives trading control. The import of the Commission's Order settling an administrative enforcement action in September 2010 against Vitol Inc. and one of its affiliates for false statements in connection with NYMEX position aggregation rules (which parallel Commission rules),[26] is that control was a pre-requisite in considering whether Vitol Inc. was required to aggregate the positions of its commonly-owned affiliate.[27] The recitation of facts in the Commission's Order

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> (viii) A business affiliate that, directly or indirectly is controlled by or is under common control with, such individual, partnership, corporation or association: P*rovided, however*, That an account owned by any shareholder or member of a cooperative association of producers, within the meaning of section 6a of the [CEA], which association is registered as a futures commission merchant and carries such account on its records, shall be deemed to be an account of a customer and not a proprietary account of such association, unless the shareholder or member is an officer, director or manager of the association."

[24] 17 CFR 1.3(y)(1)(viii).

[25] 78 Fed. Reg. 68,956 citing 17 CFR 1.3(y).

[26] "Ownership of Accounts – Except as set forth in Section E. below, any person holding positions in more than one account, or holding accounts or positions in which the person by power of attorney or otherwise directly or indirectly has a 10% or greater ownership or equity interest, must aggregate all such accounts or positions unless such person is a limited partner, shareholder, member of a limited liability company, beneficiary of a trust or similar type of pool participant in a commodity pool. […]." CME Rule 559.D.2, available at http://www.cmegroup.com/rulebook/CME/I/5/5.pdf. Certain commodities are currently subject only to position limit rules set by designated contract markets ("DCMs"). Aggregation for purposes of DCM-set position limits today is governed by Core Principle 5 "Position Limitations or Accountability" in CEA section 5(d)(5) and subpart F of 17 CFR part 28. CEA section 5(d)(1)(B) provides that DCMs have "reasonable discretion in establishing the manner in which the board of trade complies with the core principles described in this subsection" unless "otherwise determined by the Commission by rule or regulation." Under 17 CFR 38.301, DCMs "must meet the requirements of parts 150 and 151 of this chapter, as applicable." The only Commission regulation that relates to the aggregation of positions for exchange-set position limits (and that was not vacated) is 17 CFR 150.5(g). 17 CFR 150.5(g) provides that DCMs must aggregate on the basis of control and does not prescribe any other standard:

> In determining whether any person has exceeded the limits established under this section, all positions in accounts for which such person by power of attorney or otherwise directly or indirectly controls trading shall be included with the positions held by such person[.]

[27] In the Matter of Vitol Inc. et al., Docket No. 10-17 (CFTC Sept. 14, 2010), available at http:// www.cftc.gov/ucm/groups/public/@lrenforcementactions/documents/legalpleading/enfvitolorder09142010.pdf. In this matter, the Commission found that Vitol Inc. and its affiliate willfully failed to correct NYMEX's misperception of the "true nature of the relationship between" Vitol Inc. and its affiliate and imposed a civil monetary penalty of $6 million.

focused on Vitol Inc.'s failure to disclose information relating to the "flow of trading information between" the affiliated entities and the "limited nature of the barriers to trading information flow between" these presumably commonly owned Vitol affiliates.[28] These facts would have been relevant only if common control were a pre-condition to the application of the position aggregation rules (as it is due to the statutory Third Party Aggregation Constraint). Tellingly, no facts relating to common ownership were included in the Order.[29]

1.4.3. The 2013 Aggregation NPRM uses an inappropriate baseline in considering the costs and benefits of its proposed owned entity aggregation rules.

In its discussion of "Cost-Benefit Considerations," the 2013 Aggregation NPRM states that its proposed owned entity aggregation policy is "more permissive than the 10% [owned entity position aggregation] threshold currently provided."[30] It therefore assumes a cost-benefit baseline that requires aggregation of positions for position limit compliance purposes based solely on ownership, regardless of the existence of common control.

This is an inappropriate baseline for two important reasons. First, as described above, neither the Commission nor DCMs (which currently are the sole administrators of position limits for all but nine agricultural commodities, including 19 of the 28 "referenced contracts"), currently require the aggregation of owned entity positions regardless of the existence of common control. Therefore, the Commission's proposal is more restrictive, not "more permissive" than (and, indeed, a dramatic departure from) the existing position aggregation regime. Second, speculative positions outside of the spot month have not been subject to position limits in 19 of the 28 "referenced contract" markets the Commission proposes to subject to position limits under an accompanying release.[31] Aggregating non-spot-month positions of entities in which passive investors make investments presents considerable new challenges, which have not been adequately considered by the 2013 Aggregation NPRM.

1.4.4. "Control" in the context of position aggregation requirements means actual control of derivatives trading, not of anything else, and therefore the owned entity aggregation requirements cannot be based on a theory of corporate control.

[28] *Id.*

[29] *See also* Order Instituting Proceedings Pursuant to Sections 6(c) and 6(d) of the Commodity Exchange Act, as Amended, Making Findings and Imposing Remedial Sanctions, at 4, http://www.cftc.gov/ucm/groups/public/@lrenforcementactions/documents/legalpleading/enfcitigroupcgmlorder092112.pdf (Sept. 21, 2012) (finding that Citigroup was liable for the position limits violation of its subsidiary Citigroup Global Markets not on the basis of owned entity aggregation requirements under 17 CFR 150.4(b), but rather on the basis of an agency theory (CEA section 2(a)(1)(B) and 17 CFR 1.2).

[30] 78 Fed. Reg. at 68,968.

[31] 78 Fed. Reg. at 75,826. AMG is commenting separately on this proposal, including proposed 150.5(a)(5) providing that aggregation requirements of exchanges must "conform to" those of the Commission under proposed 150.4.

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As noted above, the 2013 Aggregation NPRM bases its proposed owned entity aggregation rules solely on CEA section 4a(a)(1)'s "ownership prong." The 2013 Aggregation NPRM suggests in defense of the 50% ownership aggregation exemption threshold in proposed 150.4(b)(2) that an ownership interest of greater than 50% "is indicative of control" and therefore warrants aggregation of an owned entity's positions even in the absence of any actual trading control. This conclusion appears to be based on conflated notions of corporate control in other contexts with trading control in the position limits context. The Commission cites a 50% equity ownership threshold used by the Federal Trade Commission and Department of Justice as "reflect[ing] a general understanding that ownership at this level poses substantial potential for direct or indirect control over an owned entity."[32] This threshold is used by these other government agencies to identify potential instances of common corporate control for the purpose of anti-trust filing requirements, not of common derivatives trading control.[33] Speculative position limits aggregation requirements are based on whether ownership is indicative of derivatives *trading control*, not corporate control.

The Commission has traditionally interpreted "control" in CEA section 4a(a)(1) and its predecessors as control of trading, not of corporate control or any other concept of control. For example, the Commission's current IAC exemption to position aggregation requirements focuses on the controller's independent control of trading decisions and lack of knowledge of the trading decisions of any other IAC.[34] Indeed, the 2013 Aggregation NPRM appropriately models the conditions for the owned entity aggregation exemption in proposed 150.4(b)(2) on the conditions for the IAC exemption, i.e. factors that demonstrate independent trading control. Similarly, the Commission's definition of "controlled account" at 17 CFR 1.3(j) means an account for which a person "actually directs trading."[35] Perhaps most important of all, the terms of the Commission's proposal appear to focus on trading control, not corporate control. The Commission's proposed general aggregation rule (150.4) requires aggregation when a person "directly or indirectly controls *trading*."

Thus, even if the Commission were to abandon the ownership theory relied upon in the 2013 Aggregation NPRM for a control theory instead, the result is the same: the proposal provides no basis for the Commission to depart from its historical view that position aggregation is required only where actual common trading control exists, e.g., when an investor controls the derivatives trading that occurs in a an owned entity's accounts.[36]

[32] 78 Fed. Reg. at 68,958, *citing* 16 CFR 801.1(b).

[33] *See* 16 CFR 802.2.

[34] 17 CFR 150.1(e).

[35] *See also* CFTC Form 102, available at http:// www.cftc.gov/ucm/groups/public/@forms/documents/file/cftcform102.pdf (prompting FCMs and others to identify "controlled accounts" of the same advisor exceeding "special account" activity thresholds).

[36] 78 Fed. Reg. at 68,958.

2. Passive Investment in Commission Regulation 4.13 Exempt Commodity Pools

2.1. The passive 17 CFR 4.13 exempt pool investor aggregation requirement should be omitted.

The 2013 NPRM proposes to require aggregation of positions in a 17 CFR 4.13 pool when a person holds a greater than 25% ownership interest in the pool under proposed 150.4(b)(1)(iii). This proposed rule is identical to current Commission rule 150.4(c)(2)(iii). The rationale for the current rule was that when there are "10 or fewer limited partners or when a limited partner has an ownership interest of 25% or greater, the limited partner" should be required to aggregate the positions of the pool.[37] The Commission was particularly concerned about single-investor pools when it adopted this requirement.[38] The only sub-paragraphs of current 17 CFR 4.13 that encompass the intended targets of this provision are sub-paragraphs (a)(1) and (a)(2). We therefore recommend that the Commission amend 150.4(b)(1)(iii) to apply to pools "the operator of which is exempt from registration <u>*under §§ 4.13(a)(1) or (a)(2)*</u>" in order for this requirement to apply to its intended targets.

3. Investment in Accounts or Pools with "Substantially Identical Trading Strategies"

Proposed 150.4(a)(2) provides that holding or controlling trading in more than one account or pool (collectively "funds") with "substantially identical trading strategies" requires aggregation ("SITS Rule"). This requirement would apply notwithstanding any other applicable aggregation exemption. In other words, the proposed SITS Rule would apply regardless of common control, significant ownership, or even knowledge of the relevant investments in funds with "substantially identical trading strategies."

The proposed SITS Rule should be omitted from any final rulemaking because it lacks sufficient rationale and is unworkable in practice, as discussed below. In the alternative, proposed 150.4(a)(2) should be amended to apply to "any person that, by power of attorney or otherwise, ~~holds or~~ <u>directly</u> controls the trading of positions" in a SITS account or pool.

3.1. The proposed SITS Rule lacks rationale.

The Commission does not provide a statutory or policy rationale for the proposed SITS Rule in the 2013 Aggregation NPRM or its 2012 predecessor.[39] The Commission's 2011 "Position Limits for Futures and Swaps" final rulemaking did contain a short rationale for a similar requirement for investments in funds with "identical trading strategies."[40] This provision, the Commission stated, was "intended to prevent circumvention of the aggregation requirements.

[37] 64 Fed. Reg. at 24,044.

[38] *Id.*

[39] There are, however, four mentions of the "identical trading strategies" rule in footnotes to the 2012 proposal. *See* e.g., 77 Fed. Reg. at 31,769 at fn. 14.

[40] *See* vacated 151.4(d).

In [the] absence of such [an] aggregation requirement, a trader can, for example, acquire a large long-only position in a given commodity through positions in multiple pools, without exceeding the applicable position limits."[41] However, the 2011 rulemaking provided no historical example of any such circumvention.[42]

Finally, the 2013 Aggregation NPRM fails altogether to consider the costs and benefits of the aggregation requirement for investments in funds that follow "substantially identical trading strategies," despite the very real costs that such a requirement would have on investors.

3.2. The proposed SITS Rule is unworkable in practice.

As a consequence of the proposed SITS Rule, a $10,000 investor in two $1 billion commodity index mutual funds using the same index may have to aggregate the positions in those two $1 billion mutual funds because they follow "substantially identical trading strategies." To provide another example, under the proposed SITS Rule, a $10,000 investor in a fund-of-funds that, in turn, invests $10,000 in two $1 billion commodity index funds that follow "substantially identical trading strategies" would have to aggregate the positions in those two $1 billion funds – even if the investor did not know how the fund-of-funds manager allocated the investor's money. (In contrast, under proposed 150.4(b)(1)'s exemption for investors in commodity pools, it appears that if an investor made a $500 million investment in a single $1 billion commodity index pool, it would be exempt from speculative position limits altogether).

To comply with the aggregation requirement of the proposed SITS Rule, the investor in the foregoing scenarios would not only have to determine how his or her funds are being invested, but also the trading strategies of all of the relevant funds and whether they meet the undefined test of being "substantially identical." Then, he or she would need a data feed to determine the size of the commodity derivatives positions in each fund determined to be using a "substantially identical trading strategy." Such a requirement would simply be unworkable in most cases (depending on, among other things, the size of the investment, the size of the funds with "substantially identical trading strategies" that the investor's money has been invested in, and the investor's other countable commodity derivatives positions). Even if it could be done (the practical impediments described above aside, there would also be significant and costly legal and operational obstacles to overcome), to implement such a compliance program to prevent inadvertent violations of speculative position limits due to the aggregation requirement of the proposed SITS Rule, would cost many times the investor's $10,000 investments.

[41] 76 Fed. Reg. at 71,654.

[42] The 2011 rulemaking was not very clear when it adopted an aggregation requirement for investments in accounts or pools with "identical trading strategies." Now, the 2013 Aggregation NPRM provides no guidance as to the meaning of "substantially identical trading strategies," nor does it explain how the concern about circumvention has changed from 2011 to 2013 that would explain the difference between "identical" and "substantially identical."

4. Independent Account Controller Exemption

We commend the Commission's inclusion of an IAC exemption that allows asset management companies to disaggregate the positions of customer accounts controlled by an IAC. We also commend the Commission for proposing to allow managers of employee benefit plans in proposed 150.4(b)(5) to qualify as IACs. We do have concerns, however, with two aspects of the proposed IAC exemption, described below.

4.1. The definition of IAC[43] should not be limited based upon CPO or CTA status.

The status of entities as registered, exempt or excluded CPOs or CTAs has nothing to do with the purpose behind the IAC: to provide for a safe harbor from aggregation requirements where there is no shared ownership or control between a parent advisor and sub-advisors. The Commission has not articulated a reason why IAC status should be limited to certain registrants on the one hand and certain exempt or excluded entities on the other. All pool operators and trading advisors should be able to avail themselves of the IAC exemption, irrespective of their status as registered, exempt or excluded.

4.2. The proposed IAC notice filing should not be required.

We question the utility of requiring asset managers to submit notice filings complying with proposed 150.4(c)(1) to claim the proposed 150.4(b)(5) IAC exemption. Under the Commission's current IAC exemption (17 CFR 150.3(e)), no such filing is required. The new proposed filing is unduly burdensome, particularly given the fact that we are aware of no abuses of the existing IAC exemption. In lieu of a notice filing, the Commission should consider a requirement to keep records on the eligible entity's and IAC's compliance with the conditions of the IAC exemption. If, however, the Commission requires a filing, it should allow for a simplified generic, omnibus filing that would provide the Commission notice that an eligible entity intends to use the exemption on a going-forward basis consistent with the terms of the exemption.

5. Summary

For the reasons stated above, we recommend that the Commission make the following changes in any final rulemaking adopting the 2013 Aggregation NPRM:

[43] Proposed 150.1 defines "independent account controller" to mean a person (1) who specifically is authorized by an eligible entity, independently to control trading decisions on behalf of, but without the day-to-day direction of, the eligible entity; (2) over whose trading the eligible entity maintains only such minimum control as is consistent with its fiduciary responsibilities for managed positions and accounts to fulfill its duty to supervise diligently the trading done on its behalf or as is consistent with such other legal rights or obligations that may be incumbent upon the eligible entry to fulfill; (3) who trades independently of the eligible entity and of any other IAC trading for the eligible entity; (4) who has no knowledge of trading decisions by any other IAC; and (5) who is (i) registered as an FCM, an introducing broker, a CTA, or an associated person of any such registrant, or (ii) a general partner, managing member or manager of a commodity pool the operator of which is excluded from registration under Rule 4.5 or 4.13.

- The Commission should not adopt the proposed owned entity aggregation as proposed. Instead, the rules should be amended as discussed above in order to address the impact on passive investors that have no control over, or even knowledge of, the specific commodity derivatives trading activities of owned entities in which they have invested.

- The Commission should amend 150.4(b)(1)(iii) to only require passive investors to aggregate positions of a Commission regulation 4.13 exempt pool based on a 25% or more ownership interest when "the operator of which is exempt from registration *under §§ 4.13(a)(1) or (a)(2)*."

- The Commission should omit the requirement to aggregate investments in funds that follow "substantially identical trading strategies" from any final rulemaking.

- The Commission should expand the scope of entities eligible to become IACs, so no distinction is made based upon CPO or CTA registration, exemption or exclusion status. In addition, the IAC notice filing requirements should be eliminated.

*   *   *

We appreciate your consideration of our comments. We stand ready to provide any additional information or assistance that the Commission might find useful. Should you have any questions, please do not hesitate to contact Matt Nevins at 212-313-1176 or Michael Loesch at Norton Rose Fulbright at 202-662-4552.

Sincerely,

Timothy W. Cameron, Esq.
Managing Director, Asset Management Group
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MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK

March 30, 2015

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

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

Re: RIN 3038-AD99; 3038-AD82; Position Limits for Derivatives and Aggregation of Positions

Dear Mr. Kirkpatrick:

Managed Funds Association ("**MFA**")[1] appreciates the opportunity to provide comments to the U.S. Commodity Futures Trading Commission (the "**Commission**" or "**CFTC**") on its notice of reopening of the comment period relating to the proposed rulemaking to establish speculative position limits for 28 exempt and agricultural commodity futures and options contracts and the physical commodity swaps that are economically equivalent to such contracts.[2] The Commission stated that it intends this comment period to provide commenters with the opportunity to discuss: (1) issues addressed at the Commission's Energy and Environmental Markets Advisory Committee ("**EEMAC**") public meeting held on February 26, 2015 or in the associated materials posted to the Commission's website, as they pertain to energy commodities; and (2) Table 11a, showing counts of the unique persons over certain percentages of the proposed position limit levels based on counts from the period of January 1, 2013, to December 31, 2014 (the "**February 2015 Notice**").[3] MFA has reviewed the February 2015 Notice and carefully considered the topics discussed at the EEMAC meeting and is offering its comments to assist the Commission in its efforts to draft final rules that achieve the Commission's objectives in a way that is consistent with legitimate industry concerns.

[1] MFA represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry's contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, the Americas, Australia and many other regions where MFA members are market participants.

[2] Position Limits for Derivatives and Aggregation of Positions, 80 Fed. Reg. 10,022 (Feb. 25, 2015); *see also* Position Limits for Derivatives, 78 Fed. Reg. 75,680 (proposed Dec. 12, 2013).

[3] Position Limits for Derivatives and Aggregation of Positions, 80 Fed. Reg. 10,022.

I. BACKGROUND & INTRODUCTION

The Commission has previously published four notices of proposed rulemaking related to the imposition of position limits on physical commodity derivatives. The Commission issued its first such notice in response to energy price volatility and subsequently withdrew the notice.[4] The Commission issued a second notice, and adopted the rules in 2011, but ultimately the United States District Court for the District of Columbia vacated the rules.[5] The Commission issued the third notice, relating to aggregation of positions, and the fourth notice, relating to re-proposed position limits, in 2013.[6] MFA commented on all four proposed rulemakings.[7]

MFA's members are interested in the Commission's new position limits regime because the members rely on fair, competitive, transparent, and liquid markets. MFA members play a vital role in the derivatives industry, including the energy markets, by assuming price risk from commercial participants (hedgers) on the long and short sides of the market, and providing the liquidity that facilitates price discovery and risk transfer for businesses around the world. Any rule proposal that could harm the liquidity or price discovery function of the derivatives markets or that could increase the costs of compliance is of concern to MFA's members.

MFA is concerned that Table 11a shows that the Commission's proposed position limits are too low. We believe the Commission's data and methodology used for setting position limits may be incomplete and/or flawed. As the Commission considers the final position limits rules, we respectfully urge it to examine carefully all relevant data and consider available alternatives in addressing concerns over excessive speculation. The commodity markets

[4]Federal Speculative Position Limits for Referenced Energy Contracts and Associated Regulations, 75 Fed. Reg. 4,144 (proposed Jan. 26, 2010), withdrawn 75 Fed. Reg. 50,950 (Aug. 18, 2010).

[5]Position Limits for Derivatives, 76 Fed. Reg. 4,752 (proposed Jan. 26, 2011); Position Limits for Futures and Swaps, 76 Fed. Reg. 71,626 (adopted Nov. 18, 2011); vacated by *Int'l Swaps and Derivatives Ass'n v. U.S. Commodity Futures Trading Comm'n*, 887 F. Supp. 2d 259 (D.D.C. 2012).

[6]Aggregation of Positions, 78 Fed. Reg. 68,946 (proposed Nov. 15, 2013); Position Limits for Derivatives, 78 Fed. Reg. 75,680 (proposed Dec. 12, 2013).

[7]Letter from Richard H. Baker, President and CEO, Managed Funds Association, to David A. Stawick, Secretary, Commodity Futures Trading Commission (Apr. 26, 2010), *available at* http://www.managedfunds.org/downloads/MFA%20CFTC%20energy%20spec%20limits.4.26.10.pdf ("**MFA 2010 Comment Letter**"); Letter from Richard H. Baker, President and CEO, Managed Funds Association, to David A. Stawick, Secretary, Commodity Futures Trading Commission (Mar. 28, 2011), *available at* http://www.managedfunds.org/wp-content/uploads/2011/06/3.28.11-MFA_Position_Limits_final.3.28.pdf ("**MFA 2011 Comment Letter**"); and Letter from Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, Managed Funds Association, to Melissa D. Jurgens, Secretary, Commodity Futures Trading Commission (Feb. 9, 2014), *available at* https://www.managedfunds.org/wp-content/uploads/2014/02/MFA-Position-Limits-final-2-9-14.pdf ("**MFA 2014 Comment Letter**"). MFA also commented on the Commission's separate rulemaking on aggregation of positions. Letter from Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, Managed Funds Association, to Melissa D. Jurgens, Secretary, Commodity Futures Trading Commission (Feb. 7, 2014), *available at* https://www.managedfunds.org/wp-content/uploads/2014/02/MFA-Aggregation-Limits-final-2-7-14.pdf.

currently function quite well. If anything, certain markets may suffer from insufficient speculation rather than too much speculation.[8]

The final position limits rules should be designed in a way that minimizes their impact on market liquidity and reduces the costs of compliance on industry participants. To achieve these goals, MFA recommends that in setting position limits, the Commission use accurate and complete data and review its methodology to establish position limits. By so doing it will avoid establishing limits that are too low and that are not reflective of actual market dynamics. MFA further recommends that the Commission adopt position limits through a two-phase approach. In the first phase, the Commission should adopt spot-month limits, finalize the definition of *bona fide* hedging, and rely on exchange position accountability levels for non-spot month contracts. In the second phase, the Commission should itself adopt position accountability levels for non-spot month contracts to provide greater flexibility to market participants and regulators and to reduce the costs of compliance with hard position limits in non-spot month contracts. To the extent the Commission determines to impose position limits outside the spot month, it should do so in the second phase of a two-phase approach, after having received the benefit of new data from the first phase.

II. COMMENTS

In developing a position limits regime, the Commission should consider a framework that does not unduly disrupt markets and minimizes unintended consequences. The Commission should strive to strike the appropriate balance among the Commodity Exchange Act's (the "**Act**") statutory considerations when imposing position limits.[9] Speculators, including MFA's members, perform an essential function in the energy markets by transferring risk from commercial participants, providing liquidity to both sides of the market,[10] reducing volatility, and contributing to the price discovery process, which benefits hedgers and all consumers and producers of energy.[11]

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[8]Testimony of Erik Haas, Director of Market Regulation, ICE Futures U.S., Before the CFTC's EEMAC Meeting 82 (Feb. 26, 2015) ("**Haas Testimony**") (stating that ICE Futures U.S. often receives complaints that markets are too wide out the curve and that "there is not enough participation"); Testimony of Lael Campbell, Director, Governmental and Regulatory Affairs and Public Policy, Exelon, Before the CFTC's EEMAC Meeting 83 (Feb. 26, 2015) ("**Campbell Testimony**") (stating "it sounds to me like we may have an excessive hedging problem.").

[9]Section 4a(a)(3) of the Act specifies that if the Commission sets federal position limits, it must strive to 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).

[10]"The short hedgers and long investors provide liquidity for each other by using futures markets to serve their respective interests in an open, transparent and efficient manner. Liquidity will be essential to make sure each can achieve their objectives at an efficient price. Artificial limits on that liquidity should not be imposed. There are numerous ways to further the objectives of enhanced transparency and reduced systemic risk that do not involve reductions in much needed liquidity." Testimony of Kevin Norrish, Managing Director of Commodities Research, Barclays Capital, Before the CFTC 4 (Mar. 25, 2010).

[11]*See*, *e.g.*, "A Review of Recent Hedge Fund Participation in NYMEX Natural Gas and Crude Oil Futures Markets", New York Mercantile Exchange (Mar. 1, 2005); "Populists versus theorists: Futures markets and the volatility of prices" (Jun. 2006), Explorations in Economic History 44 (2007) 342-362, David S. Jacks, *available*

MFA is concerned, however, that the proposed position limits may constrain effective risk transfer by unduly restricting hedging or limiting the risk-bearing capacity of large speculators, thereby causing reduced liquidity, wider bid-offer spreads and higher transaction costs.[12] Market participants already are moving to over-the-counter transactions where they incur bilateral exposure because futures contracts have become too costly the further out the curve one goes.[13] We are also concerned that the Commission's proposed position limits may actually undermine the Commission's intent to encourage market transparency and reduce systemic risks through centralized clearing.[14] We believe that the proposed limits will cause participants to move their transactions to less-transparent and non-cleared markets due to a lack of liquidity on futures markets. In our letter, we identify some specific concerns with respect to the Commission's proposed position limits and provide recommendations.

A. The Commission's Basis for Position Limits Should Be Based Upon Accurate and Reliable Data

MFA is concerned that the Commission's data – including the new data in Table 11a that provides the number of unique persons over specified percentages (i.e., 60%, 80%, 100%, or 500%) of the 28 proposed position limit levels from January 1, 2013, to December 31, 2014 – appear to demonstrate that the position limits have been set too low. Moreover, the data provided appear insufficient to permit a meaningful analysis of the impact of the proposed position limits regime on market participants. MFA respectfully requests that the Commission reevaluate position limits using additional, reliable, high-quality data relevant to the energy commodity markets, especially for contracts for which the Commission has not made a necessity finding.[15]

<u>1. The Data Demonstrate That the Proposed Position Limits Are Miscalibrated and Have Been Set Too Low</u>

Table 11a identifies the number of unique persons at or above various percentages of the proposed position limit levels. As we describe below, it is difficult to analyze the data in Table 11a because the Commission does not provide sufficiently detailed information to identify whether the unique persons are engaged in hedging or speculative activity. However, without more information from the Commission, we can only assume that a portion of unique persons are speculators. For example, Table 11a identifies 205 unique persons holding cash-settled NYMEX

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*at*www.sciencedirect.com. We have referenced these studies in previous comment letters. *See* MFA 2010 Comment Letter at 2; MFA 2014 Comment Letter at 13.

[12]During the EEMAC Meeting, Erik Haas explained that hedging further out the curve is "getting more expensive and harder to do" and, in turn, bid-offer spreads are wider. Haas Testimony at 82.

[13]*See, e.g., id.* at 90-91.

[14]*See, e.g.*, Position Limits for Derivatives, 78 Fed. Reg. at 75,737. The Commission describes the goals of position limits as "deterring market manipulation, ensuring the price discovery function of the underlying market is not disrupted, and deterring disruptive trading during the closing period." *Id.*

[15] While MFA's comments in this letter pertain to energy contracts, MFA believes that the Commission should consider the same issues in the context of metals contracts.

Henry Hub contracts in the spot month that represent 80% of the proposed position limit level; 187 unique persons hold positions equivalent to 100% of the proposed position limits; and 46 unique persons hold positions equivalent to 500% of the proposed position limits.[16] Based on these data, it appears that the markets are functioning with a high level of legitimate activity near, at or above the proposed position limit levels. The Commission's intent appears to be to restrict this activity by imposing position limits. The Commission seems to suggest that excessive speculation exists in the markets, but the Commission has not made a finding that there is excessive speculation at the position limit levels it has proposed, where, currently, a great deal of activity occurs.

With no finding that excessive speculation currently exists in the energy contract markets or other markets, and considering the large number of unique persons above 80%, 100% or 500% of the proposed position limit levels in many commodities in Table 11a in both the spot and non-spot months, it appears that the Commission is proposing position limits at levels that are too low. The data in Table 11a appear to indicate that there are a large number of traders who are close to exceeding or exceeding the proposed position limit levels. In the event of a sudden change in market conditions, the proposed position limits would even constrain the abilities of unique persons at the 80% level to manage risk because there would be little flexibility under the proposed position limit levels for market participants to take on more positions. Table 11a leads us to conclude that in setting position limits, the Commission is relying upon incomplete data and/or the methodology for setting spot month and non-spot months are inappropriate.[17]

By contrast, position accountability levels, which have been used successfully by futures exchanges, would provide the necessary flexibility to enable market participants to respond to changes in market conditions without violating hard position limits.[18] Accordingly, MFA requests that the Commission reevaluate the proposed position limits in the context of relevant market data and methodology specific to each commodity and, as further discussed below, establishing position accountability levels in the non-spot months.

2. The Data Are Not Sufficiently Detailed to Effectively Analyze the Proposed Position Limits

The lack of transparency as to the Commission's data and methodology that underlie important portions of the proposed position limits rule makes it difficult, if not impossible, for affected market participants to evaluate and meaningfully comment on significant aspects of the proposal. For example, the data in Table 11a have been compiled over a two-year period; however, the Commission has not identified whether the unique persons at or over the percentages of the proposed position limits would have breached these levels on just one day out

[16] Position Limits for Derivatives and Aggregation of Positions, 80 Fed. Reg. at 10,025.

[17] *See* Position Limits for Derivatives, 78 Fed. Reg. 75,680 (proposed Dec. 12, 2013) (proposing to set spot month limits at 25% of deliverable supply, and single-month and all-months-combined limits at 10% of the first 25,000 contracts and 2.5% of open interest beyond 25,000 contracts).

[18] *See infra* Section C for a discussion on position accountability levels.

of the two-year period or on all of the days of the two-year period. It is unclear whether or how the Commission verified the data in Table 11a, for example, by contacting the unique persons at or over the specified percentages of the proposed position limits to confirm the Commission's calculations.

The data in Table 11a do not distinguish unique persons who are speculators and hedgers at each percentage level. In fact, the Commission does not know "whether a trader's position today is hedge or spec" because the Commission does not gather this level of detailed information in its Commitment of Traders Reports.[19] The identification of hedgers and speculators at or above the specified percentages of the proposed position limits is fundamental to effectively determine the impact of the proposed position limits. Where there is a greater number of speculators at a given percentage level, the proposed position limits will have a more significant impact. Without more information, it is difficult to analyze the impact the proposed position limits would have on the energy markets.[20] Thus, MFA recommends that the Commission obtain and analyze further data before considering implementing position limits.

3. The Commission Should Consider Market-Appropriate Methodology and Data with Respect to Position Limits

If the Commission determines to impose position limits, MFA encourages the Commission to reconsider the methodology and data it has used to establish the proposed position limits for the spot month and outside of the spot month.

The Commission uses the deliverable supply of a commodity to compute spot month limits. However, the Commission should not use a one-size-fits-all method of computation. Deliverable supply should be calculated differently for energy markets than for other commodity classes by considering energy products that are in a different location but can serve demand in certain areas through the transportation of the products. Thus, estimated deliverable supply should be based on pipeline capacity for natural gas and transmission for power as opposed to load or generation at a certain location.[21]

With respect to non-spot month limits, the Commission's data and proposed position limits should take into account the fact that open interest traits varies widely between agricultural

[19] Testimony of Stephen Sherrod, Senior Economist, Division of Market Oversight, CFTC, Before the CFTC's EEMAC Meeting 85 (Feb. 26, 2015).

[20] MFA has commented on the reliability of the Commission's data in the past. In the MFA 2014 Comment Letter, we shared our concern about the accuracy of the data used to measure open interest of over-the-counter swaps and noted that the Commission has acknowledged reporting errors. The Commission has stated: "Several reporting entities have submitted data that contained stark errors. For example, certain reporting entities submitted position sizes that the Commission determined to be 1000 times, or even 10,000 times, too large." Position Limits for Derivatives, 78 Fed. Reg. at n.428, 75,734. *See also* Dissenting Statement of Commissioner Scott O'Malia, Position Limits for Derivatives, 78 Fed. Reg. at 75,841 ("It is especially troubling that the large trader data being reported under Part 20 of Commission regulations is still unreliable and unsuitable for setting position limit levels, almost two full years after entities began reporting data, and that we are forced to resort to using data from 2011 and 2012 as a poor and inexact substitute.") (internal citation omitted).

[21] Haas Testimony at 100.

and energy markets. Agricultural markets have relatively few contract months with open interest in the back months because the majority of open interest is front-loaded in the first two or three contract months.[22] In contrast, open interest in ICE's Henry Hub contract exists across 142 different contract months, with only 20% of that open interest in the front three contract months.[23] In fact, to reach the 99% level of open interest in ICE's Henry Hub contract, one must look out 70 months.[24]

Different levels of open interest for agricultural and energy markets establish a meaningful distinction between these markets. The high level of open interest in the back months of the energy markets translates to the need for liquidity in these longer-dated contracts to effectively manage risk out the curve. All-months-combined position limits in energy contracts could severely constrain liquidity in longer-dated contracts, especially if: (1) the limits are set in the same manner as for agricultural contracts; and (2) it is the same entities providing speculative liquidity in the longer-dated contracts as in short-dated contracts. It is not clear that if existing speculators are limited from providing liquidity in longer-dated contracts that new market participants will step in to fill that void given the inherent risks in trading in more illiquid contracts. Thus, MFA recommends that the Commission analyze the different traits and characteristics of markets and use market-appropriate methodology in setting position limits, or considering whether single month and all-months-combined limits are even necessary in some markets.

4. The CFTC Should Reevaluate Position Limits Where It Has Not Made a Necessity Finding

We do not believe that the Commission has demonstrated that position limits are necessary outside of the spot month; and accordingly are not convinced that the proposed limits set forth in Table 11a would not harm market participants or markets. The Commission has not offered empirical support for the propositions that hard position limits are necessary, have reduced undue price volatility in agricultural commodities or will reduce volatility in energy markets.[25] The Commission does not explain why the agricultural model would be correctly applied to energy contracts in view of the different characteristics that distinguish these markets. MFA believes the Commission should make a necessity finding prior to imposing position limits, particularly because the energy markets have unique characteristics that differentiate them from the agricultural markets; but also to ensure that position limits would not harm market participants or markets.

[22] *Id.* at 66-67.

[23] *Id.*

[24] *Id.* Only 50% of open interest in ICE's Henry Hub contract is in the first year. *Id.* Eighty-three different contract months exist for power contracts, with 50% of open interest in the first 12 contract months and 99% of open interest 60 months out the curve. *Id.*

[25] "[W]e do not believe a case has been made which demonstrates that prices of commodities, or other financial derivatives, can be effectively controlled through the mandatory operation of regulatory tools such as position limits, whether on exchange or OTC. Analysis of market data where position limits are already in use suggests this has not shown a reduction in volatility or absolute price movements compared to contracts where they are not." Financial Services Authority & HM Treasury, Reforming OTC Derivative Markets, A UK perspective (Dec. 2009), at 34.

The energy markets are more global, energy commodities are more fungible, supplies of energy commodities are much greater and production is subject to less seasonal variation than with agricultural commodities. Macro events affect energy markets' liquidity needs on a larger scale than they affect agricultural markets. For example, in 2011, due to civil unrest in the Middle East (the "Arab Spring"), production of crude oil suddenly declined by 1.5 million barrels per day, while demand for crude oil was increasing from growth in emerging markets.[26] Position limits could harm market participants and markets if they limit the ability of market participants to respond quickly to these types of global events, seasonal trends or other economic forces.

Also, as discussed above, the distribution of open interest in energy markets is significantly different from agricultural markets in that open interest is concentrated less in the first two or three contract months but extends to multiple months beyond the spot month. As such, all-months-combined limits would likely impact energy markets more drastically than agricultural markets. Again, it is not clear to us that single month or all months limits are necessary in the energy markets, or that they would not impose more harm than benefit.

The energy commodity markets are well functioning, as demonstrated by the existence of model convergence and transactions in contracts with wide-ranging maturities in the energy markets.[27] Where there are low levels of liquidity in contracts with further-dated maturities (such as several years from delivery), such low liquidity appears to be caused by "excessive hedging" that could be solved by increasing the number of speculators to increase liquidity in further-dated contracts.[28] MFA is concerned that the Commission has determined to impose position limits even though it has not found that position limits are necessary with respect to energy commodities, and encourages the Commission to conduct further analysis on the necessity of position limits before imposing limits. As discussed below, MFA recommends that the Commission adopt position accountability levels outside of the spot month, or rely on exchange position accountability levels, in order to collect further data to assist in analyzing energy markets, as discussed below.

B. The Commission Should Adopt Position Limits Through A Two-Phase Rulemaking Approach

In light of concerns regarding the sufficiency of the data being used by the Commission, MFA believes that the Commission should adopt position limits through a two-phase rulemaking approach. In the first phase, the Commission should adopt spot-month position limits, finalize the *bona fide* hedging definition, and rely on exchange position accountability levels for non-spot months. During the second phase of rulemaking, the Commission should adopt position accountability levels for non-spot months based upon data gathered during the first phase. The phased-in approach decreases the risk of market disruption by affording the Commission better

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[26]U.S. Energy Information Administration, 2011 Brief: Brent Crude Oil Averages Over $100 Per Barrel in 2011, *available at* http://www.eia.gov/todayinenergy/detail.cfm?id=4550.

[27]*Id.*at 69.

[28]Campbell Testimony at 83.

data on which to base non-spot month position accountability levels and by giving market participants adequate time to comply with a comprehensive position limits regime encompassing a large number of contracts.

MFA encourages the Commission to adopt a two-phase approach to position limits to enable the Commission to observe the functionality and impact of the spot-month limits and better understand the impact from the change in definition of *bona fide* hedging on market behavior. The Commission could use this information to measure the impact of spot-month position limits on the markets and to analyze position accountability levels for non-spot months. Recently, the Commission has implemented a phased-in approach for other types of rulemakings to ease the transition for market participants.[29] A phased-in approach should be adopted for the position limits regime to provide market participants with adequate time to adjust their internal operations and risk management systems and compliance programs to the new position limits regime, while decreasing the likelihood of constricting liquidity in any of the 28 exempt and agricultural commodity futures and options contract markets.

After implementing the first phase, the Commission will have the benefit of new data. Thus, even if the Commission determines that position limits are necessary outside of the spot month rather than position accountability levels, it will at least have better data on which to base position limits. MFA respectfully requests the Commission to implement this type of two-phase approach when adopting the final position limits regime.

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[29] For example, the Commission addressed similar concerns related to the adverse impact that the adoption of the residual interest requirement under the enhancing customer protection rules would have on the market, if the Commission made the deadline for compliance with that requirement by futures commission merchants' ("FCMs") and their customers' too short. Commission final rule "Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations", 78 Fed. Reg. 68,506 (Nov. 14, 2013), available at: http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/federalregister031715.pdf.. In response to market participants' concerns, in the final rule, the Commission set the initial residual interest deadline as 6:00pm ET on the date of settlement, and provided a five-year phase-in approach during which the deadline for FCMs' compliance would automatically decrease over time. In addition, during the phase-in, the Commissioner required Commission staff to complete and publish for public comment a report addressing the practicability for FCMs and customers of complying with a shorter deadline. *See id*. at 68,550, 68,578.

Using such a phase-in approach allowed the Commission to analyze the market impact of shortening the residual interest deadline and determine that the automatic decreases of the deadline provided in the final rule were inappropriate. As a result, on March 17, 2015, to "provide the Commission with a greater degree of flexibility to assess all relevant data, including the costs and benefits of revising the Residual Interest Deadline", the Commission approved a new final rule that terminated the phase-in compliance period for the residual interest deadline, and made permanent the existing deadline of 6:00pm ET on the date of settlement. Commission final rule "Residual Interest Deadline for Futures Commission Merchants", 80 Fed. Reg. 15,507 (Mar. 24, 2015), available at: http://www.gpo.gov/fdsys/pkg/FR-2015-03-24/pdf/2015-06548.pdf.

C. The Commission Should Impose Position Accountability Levels Rather Than Hard Limits Outside of the Spot Month

MFA recommends that the Commission adopt position accountability levels instead of position limits outside of the spot month to increase the Commission's regulatory flexibility and the flexibility of market participants. The Commission should adopt position accountability levels during the second phase of rulemaking as MFA recommends above. To the extent the Commission determines to impose position limits rather than position accountability levels, it should still do so as part of the second-phase of a two-phase approach. The position accountability regime has been successfully applied by futures exchanges and allows regulators to obtain a deeper insight into market dynamics through dialogue with market participants as they become near or exceed the position accountability threshold.

<u>1. The Commission Should Adopt a More Flexible Approach to Achieve a Better Outcome</u>

Futures exchanges impose position accountability levels because they maintain the market's integrity by providing necessary oversight of any market participant while ensuring sufficient liquidity to allow traders to enter and exit the market without being overly burdensome to traders who, at times, may hold large positions. Position accountability levels are similar to position limits in that a trader who reaches the position accountability level will be exposed to increased exchange scrutiny of the trader's positions. Unlike position limits, position accountability levels do not prohibit a trader from reaching or exceeding the level. Instead, once a trader hits a position accountability level, an exchange may take certain actions, including preventing the trader from increasing the position or requiring the trader to reduce the position.[30] Since at least 1991,[31] the Commission has permitted exchanges to impose position accountability

[30]CME Rule 560 (stating in part: "A person who holds or controls aggregate positions in excess of specified position accountability levels or in excess of position limits pursuant to an approved exemption shall be deemed to have consented, when so ordered by the Market Regulation Department, not to further increase the positions, to comply with any prospective limit which exceeds the size of the position owned or controlled, or to reduce any open position which exceeds position accountability or position limit levels."); ICE Futures U.S. Rule 6.13 (providing the exchange with the authority to "instruct each such Clearing Member to reduce the positions in such accounts twenty-four (24) hours after receipt of the notice, proportionately or otherwise so that the aggregate positions of such accounts at all such Clearing Members does not exceed the position limits and position accountability levels established by this Chapter").

[31]In 1991, the Commission granted CME an exemption from position limits with respect to foreign currency and financial instrument contracts. Speculative Position Limits – Exemptions From Commission Rule 1.61; Chicago Mercantile Exchange Proposed Amendments to Rules 3902.D, 5001.E, 3010.F, 3012.F, 3013.F, 3015.F, 4604, and Deletion of Rules 3902.F, 5001.G, 3010.H, 3012.H, 3013.H, and 30.15.H, 56 Fed. Reg. 51,687, 51,688 (Oct. 15, 1991). The Commission provided that energy contracts would be eligible for exemptive relief because they are characterized by underlying cash markets with liquidity equal to or greater than certain financial futures and options that the Commission had already exempted. *See* Revision of Federal Speculative Position Limits and Associated Rules, 63 Fed. Reg. 38,525, 38,530 (proposed Jul. 17, 1998). Under the proposed position limits rules, the Commission would allow an exchange "to establish position accountability rules as an acceptable alternative to position limits outside of the spot month for physical commodity contracts when a contract has an average month-end open interest of 50,000 contracts and an average daily volume of 5,000 contracts and a liquid cash market." Position Limits for Futures and Swaps, 76 Fed. Reg. at 71,660.

levels on certain contracts.[32]

Exchanges value the flexibility provided by position accountability levels because they can make educated determinations as to whether a trader's positions could become problematic. The further out the curve market participants transact in derivatives, the number of market participants and liquidity both decrease.[33] Those traders who engage in the first trade in a back month will hold all of the open interest in that contract, but this is not necessarily problematic.[34] Rather, it is essential to creating liquidity in these contract months.[35] Moreover, exchanges can continually monitor *concentrations* the further out the curve a trader is transacting.[36] Position accountability levels enable exchanges to monitor different levels of open interest without adversely impacting liquidity, yet provide the exchanges with the authority to intervene when appropriate.

Position accountability levels are intended to be a proactive method of monitoring the markets, and therefore it is appropriate to apply position accountability levels outside of the spot month and analyze concentrations using multiple factors to "cumulatively determine if a position should be continued to be carried."[37] For example, CME considers the following factors to determine the appropriate action to take when a market participant reaches the position accountability level: (1) the absolute size of the position relative to the size of open interest in the relevant contract; (2) the nature of the market participant's business (speculator, traditional hedger, or swap dealer); (3) the size of the position relative to other position holders or comparable entities; (4) the type of the position (outright, intra-commodity spread, inter-commodity spread); (5) the location of the position on the curve (expiration, near expiration or deferred month); (6) market fundamentals (whether there is a congested market, unusual basis or spread relationship); (7) the position relative to the historical position levels for the account in question as well as the account's history of managing its positions; and (8) whether the market participant exhibits abrupt position accumulation or uncharacteristic behavior in the marketplace.[38] Exchanges intentionally set low position accountability levels to enable an

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[32]CFTC Regulations 37.600(a) and 38.300 require exchanges to adopt position limitations or position accountability levels for speculators as is necessary and appropriate with respect to contracts for which there are no federal limits. 17 C.F.R. §§ 37.600(a), 38.300.

[33]Haas Testimony at 107.

[34]*Id.*

[35]*Id.*

[36]Testimony of Thomas LaSala, Managing Director and Global Chief Regulatory Officer of Market Regulation, CME Group, Before the CFTC's EEMAC Meeting 107 (Feb. 26, 2015) ("**LaSala Testimony**"). To illustrate the value of position accountability levels and the flexibility they provide for different types of contract months, Thomas LaSala of CME described in his EEMAC testimony various levels of open interest that CME monitors. *Id.* LaSala states that the exchange is interested in traders who hold approximately: (1) 45% of the open interest in the back months; (2) 30%-35% of the open interest in the third to sixth contract months; (3) 20%-25% of the open interest in the second contract month; and (4) 15%-20% of the open interest in the front month. As the spot month approaches, the exchanges continue to scrutinize traders' positions. *Id.*

[37]Haas Testimony at 97-98.

[38]LaSala Testimony Materials, *available at* http://www.cftc.gov/ucm/groups/public/@newsroom/documents/generic/eemac022615_lasala2.pdf.

exchange to gather information in a proactive, timely manner. If an exchange determines that a position may become excessive, the exchange has the authority to prohibit a trader from adding to the position and/or order the trader to reduce the position.[39] In the event that the position does not threaten to disrupt or otherwise harm the integrity of the market, the exchange will maintain a dialogue with the trader to proactively monitor the position.

The position accountability regime is more appropriate for energy markets than the position limit regime because market participants can trade in a greater number of contract months further out the curve without the fear of a regulator bringing a disciplinary action for violating a position limit. By permitting market participants to take a position close to or above position accountability levels, liquidity and price discovery will not suffer and the Commission could continue to monitor the market participant's position and take actions (such as order the market participant to reduce or liquidate the position) as they become necessary or appropriate.

By adopting a position accountability regime outside of the spot month, the Commission would achieve its goals of preventing excessive speculation and market manipulation without compromising liquidity needs and the price discovery function. The Commission would gain a deeper understanding of market dynamics and be afforded a flexible approach to actively review positions by analyzing various factors that cause a market participant to take on a larger-than-normal position.[40] MFA encourages the Commission to impose position accountability levels outside of the spot month instead of position limits to more flexibly achieve its goals without causing harm to the markets. MFA realizes that this approach could require the Commission to issue a rule proposal on position accountability levels. A staged adoption of position limit rules, as suggested above, would provide the Commission with the opportunity to first adopt position limits for spot month contracts and rely on existing exchange position accountability levels outside of the spot month, and study the impact of position limits on the markets while considering the adoption of position accountability levels outside of the spot month.

2. A Position Accountability Regime Would Reduce Compliance Costs for Market Participants and Would Be Less Likely to Impair Liquidity

The Commission should also take into account the not-insignificant costs related to compliance with the position limits regime. This is of particular concern as the compliance costs may deter some market participants from otherwise participating in the futures markets. Fewer market participants in the futures markets could negatively impact market liquidity for *bona fide* hedgers and disrupt the price discovery function of the markets.[41] During the EEMAC Meeting, participants discussed the burden compliance costs would impose on market participants.[42] MFA is concerned that the Commission underestimates the number of affected parties and the

[39] *See, e.g.*, CME Rule 560 and ICE Futures U.S. Rule 6.13.

[40] MFA 2014 Comment Letter at 20-23.

[41] *See* Section 4a(a)(3) of the Act; 7 U.S.C. § 6a(a)(3).

[42] Haas Testimony at 91 (describing that market participants are willing to trade over the counter, where they take on counterparty risk, to avoid the high costs associated with trading futures).

costs of compliance with the proposed position limits, and that the potential unintended consequences of the rules will greatly outweigh any purported benefits.

The compliance costs associated with position limits are significantly high, and are disproportionately burdensome for those who are unlikely to ever come close to reaching the limits. MFA members would need to establish monitoring systems to ensure compliance with hard position limits if the Commission chooses to adopt position limits for the spot month and all other months. MFA members' compliance with position limits translates into costly day-to-day and intra-day monitoring of positions in the spot month and outside of the spot month, especially because violating a hard position limit by even one contract can result in disciplinary sanctions. These monitoring challenges are compounded for firms employing numerous traders in multiple locations, or who must aggregate positions with other firms under the Commission's aggregation rules. The costs of compliance with hard position limits could act as a disincentive to trade or hold legitimate positions, resulting in decreased market liquidity and higher transaction costs.

MFA believes that position accountability levels would serve as a less costly and disruptive alternative to position limits. Position accountability levels serve a similar purpose as position limits, but would be less costly for market participants to comply with and, thus, be less likely to negatively impact market liquidity and price discovery. MFA respectfully requests that the Commission compare and weigh the costs-benefits of the proposed position limits regime with a position accountability regime on the markets.

3. <u>The Commission Has the Authority to Impose Position Accountability Levels and Should Exercise This Authority</u>

The Act provides the Commission with the authority and discretion to adopt position accountability levels. The Act authorizes the Commission to determine that position limits outside of the spot month are not necessary or to exempt non-spot months from position limits.[43] Section 4a(a)(1) of the Act sets forth the Commission's broad authority to set position limits as the Commission finds are necessary to diminish, eliminate, or prevent such burden to interstate commerce caused by excessive speculation that causes sudden or unreasonable fluctuations or unwarranted changes in the price of such commodity.[44] However, if the Commission makes a necessity finding for all energy markets, the Commission should exempt energy contracts that are outside of the spot month from the hard position limits requirement in accordance with the explicit provisions of Section 4a(a)(7) of the Act.[45]

By determining that position limits are not necessary for contracts outside of the spot month or exempting such contracts from the proposed position limits regime, the Commission may apply other more appropriate methodologies to prevent excessive speculation outside of the

[43] Sections 4a(a)(1), 4a(a)(7) of the Act; 7 U.S.C. §§ 6a(a)(1), 6a(a)(7).

[44] Section 4a(a)(1) of the Act; 7 U.S.C. § 6a(a)(1).

[45] Section 4a(a)(7) provides that "[t]he 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." 7 U.S.C. § 6a(a)(7).

spot month. Section 4a(a)(2) of the Act provides that "the Commission shall by rule, regulation, or order establish limits on the amount of positions, ***as appropriate***, other than bona fide hedge positions, that may be held by any person."[46] Section 8a(5) of the Act authorizes the Commission "to make and promulgate such rules and regulations as, in the judgment of the Commission, are reasonably necessary to effectuate any of the provisions or to accomplish any of the purposes of this chapter."[47] For the reasons set forth above in Section C.1, a position accountability regime is more appropriate for non-spot month contracts in the energy markets. MFA respectfully requests that the Commission exercise its authority under Sections 4a(a)(2) and 8a(5) of the Act to the Commission's consideration of an appropriate position limits regime applicable to energy contracts outside of the spot month.

III. CONCLUSION

MFA shares the Commission's desire to preserve and enhance the integrity of our markets. However, MFA is concerned that the Commission needs further data and to review its methodology in order to set appropriate position limits. We are concerned that the proposed position limits are miscalibrated and have been set too low. In setting position limits, the Commission should consider market-specific methodology and data, given the unique characteristics and traits of the energy markets. We are not convinced that position limits are necessary outside of the spot month for energy markets, and believe the Commission should conduct further analysis to ensure that such limits are necessary, appropriate, and if implemented, that they would not disrupt markets and the ability of market participants to hedge commercial risk.

MFA recommends that the Commission adopt position limit through a two-phase approach to decrease the risk of market disruption by affording the Commission better data on which to base non-spot month position accountability levels or position limits. MFA respectfully urges the Commission to consider the benefits of implementing position accountability levels instead of position limits outside of the spot month. Position accountability levels serve a similar function as position limits, but in a manner that would provide the Commission and market participants with greater flexibility to adjust to changing market conditions. It would also be significantly less costly from a compliance perspective; and less likely to harm market liquidity and price discovery. Nevertheless, to the extent the Commission determines to implement position limits for non-spot months, we recommend that it adopt such limits in the second phase of a two-phase approach.

[46]Section 4a(a)(2) of the Act; 7 U.S.C. § 6a(a)(2) (emphasis added).

[47]Section 8a(5) of the Act; 7 U.S.C. § 12a(5).

We appreciate the opportunity to offer comments to the February 2015 Notice. We would be happy to discuss our comments or any of the issues raised by the Commission's position limits proposal at greater length with the Commission or its staff. If the staff has any questions, please do not hesitate to call Jennifer Han, Associate General Counsel, or the undersigned at (202) 730-2600.

Respectfully Submitted,

/s/ Stuart J. Kaswell

Stuart J. Kaswell
Executive Vice President & Managing Director, General Counsel
Managed Funds Association

cc:

The Honorable Chairman Timothy Massad
The Honorable Commissioner Mark Wetjen
The Honorable Commissioner Sharon Bowen
The Honorable Commissioner J. Christopher Giancarlo

MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK

November 12, 2015

Via CFTC Web site: http://comments.cftc.gov

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

Re: RIN 3038-AD82

Dear Mr. Kirkpatrick:

Managed Funds Association ("**MFA**")[1] appreciates the opportunity to provide comments to the Commodity Futures Trading Commission (the "**Commission**" or "**CFTC**") on its supplemental notice of proposed rulemaking concerning aggregation of positions (the "**Supplemental Proposal**").[2] MFA and its members have been especially interested in the Commission's aggregation of positions proposals regarding modifications to part 150 of the Commission's regulations as MFA members may implement multiple independent trading strategies, may be invested in "owned entities" (including operating companies that are not commodity pools), and may be passive owners in the fund-of-funds context.

MFA submitted comments to the Commission's 2013 Aggregation of Positions proposal[3] (the "**Aggregation Proposal**") ("**MFA 2014 Aggregation Letter**") and is pleased to see the Supplemental Proposal, which proposes a modification to the Aggregation Proposal with respect to the aggregation provisions of part 150. The Supplemental Proposal proposes to extend the notice filing and conditions for relief from aggregation for entities with an ownership interest of

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[1] Managed Funds Association (MFA) represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry's contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, North and South America, and many other regions where MFA members are market participants.

[2] Supplemental Proposal, 80 Fed. Reg. 58,365 (Sept. 29, 2015), available at: http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2015-24596a.pdf.

[3] Aggregation of Positions, 78 Fed. Reg. 68,946 (proposed Nov. 15, 2013), available at: http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2013-27339a.pdf.

between 10 and 50 percent in another entity, as proposed in the Aggregation Proposal,[4] to owners that have more than a 50 percent ownership interest in another entity.[5] MFA generally supports the Supplemental Proposal and provides additional comments to the Commission on aggregation of positions under part 150.

I. EXECUTIVE SUMMARY

MFA provides comments and recommendations with respect to the Supplemental Proposal and the Aggregation Proposal, which are summarized as follows:

- MFA supports the provision in the Supplemental Proposal to provide relief through a notice filing process to owners of more than 50 percent of an owned entity from aggregating positions with those held by owned entities under the Commission's aggregation exemption.

- MFA supports modifying the disaggregation relief criteria to require only affirmative obligations by an "Owner" entity.

- MFA respectfully believes that the Commission should amend aspects of the Supplemental Proposal to coordinate better with other changes to CFTC rules as well as to accommodate changes in the industry. As a result of statutory changes, the operators of many investment funds are now considered commodity pool operators due to swaps exposure in the pools they operate; and seek a Rule 4.13(a)(3)[6] exemption from registration for trading a *de minimis* level of commodity interests. Rule 4.13 was amended subsequent to the adoption of the original aggregation exemption rule to include subsection (a)(3). Since Rule 4.13(a)(3) pools were not the type of entities that the Commission was concerned with when it promulgated the aggregation exemption and the industry has changed, MFA recommends the following amendments:

    - Amending the aggregation of accounts exemption to take into account subsequent rule amendments to Rule 4.13 and changes in the commodity pool industry. MFA recommends that the Commission amend proposed rule 150.4(b)(1)(iii) to apply only to participants that have a 25 percent or greater ownership in a pool, the operator of which is exempt from registration under sections 4.13(a)(1) or (2).

    - Amending the Rule 150.1 definitions of the terms "Eligible entity" and "Independent account controller" to expand the classes of entities eligible for the exemption to reflect industry changes regarding the professional management of trading funds.

[4] Aggregation of Positions at 68,958.

[5] Supplemental Proposal at 58,369.

[6] 17 C.F.R. 4.13(a)(3).

II. COMMENTS TO DISAGGREGATION RELIEF FOR OWNED ENTITIES

A. MFA Supports the Disaggregation Relief for Owners of More Than 50 Percent of an Owned Entity Based on Notice Filing

MFA supports providing relief to owners of more than 50 percent of an owned entity from aggregating positions held by owned entities through a notice filing process. We appreciate the Commission's earlier attempts to provide a bright-line test under the aggregation exemption by allowing owners of between 10 and 50 percent of an owned entity to seek relief under the aggregation exemption through a notice filing process, and requiring owners of more than 50 percent to seek relief through a different process.[7] However, as ownership is not always indicative of control, we believe it is appropriate for the Commission to extend the same proposed relief from aggregation for owners of more than 50 percent of an owned entity as to owners of between 10 and 50 percent of an owned entity. As the Commission has acknowledged, "aggregation of positions held by owned entities may in some cases be impractical, burdensome, or not in keeping with modern corporate structures."[8]

The U.S. capital markets have been successful in enabling the efficient deployment of capital between investors and businesses needing resources to grow. MFA member firms or other institutional investors may engage in multiple, independent investment/trading strategies that are implemented by different and separate business units or employees. As such, we appreciate the Commission's disaggregation relief and offer some further recommendations to achieve the goal of allowing efficient capital allocation yet ensuring that a person does not create an unduly large speculative position through control of multiple accounts.

B. MFA Recommends Modifying the Disaggregation Relief Criteria to Only Require Affirmative Obligations by an "Owner" Entity

MFA is concerned that an entity that owns 10 percent or more (an "**Owner**") of an operating company (an "**Owned Entity**") will not be able to satisfy the disaggregation criteria under proposed rule 150.4(b)(2) because such Owners are often not large or important enough to garner the attention of the operating company, *i.e.*, the Owned Entity.[9] , As a condition for allowing disaggregation by certain owners of greater than 10 percent in an Owned Entity, proposed rule 150.4(b)(2) would provide criteria that an Owner and an Owned Entity must meet to qualify.[10]

[7] Aggregation of Positions at p. 68,959.

[8] *Id.*

[9] In the MFA 2014 Aggregation Letter, MFA recommended that the Commission increase the 10 percent threshold under proposed rule 150.4(b)(2) to 25 percent to address the concern that a 10 percent Owner may not be influential enough to garner the prompt attention and response of an Owned Entity. MFA believes this issue may be addressed by only requiring an affirmative obligation by an Owner for purposes of the aggregation exemption, as discussed in Section B.

[10] Proposed rule 150.4(b)(2), *Exemption for certain ownership of greater than 10 percent in an owned entity*, provides:

The criteria include that the Owner and the Owned Entity have certain written procedures. MFA believes that it could be very difficult and burdensome for an Owner to ensure that an Owned Entity is complying with the Commission's regulations to warrant disaggregation. Thus, MFA recommends that the Commission modify proposed rule 150.4(b)(2) to require only an affirmative obligation by the Owner of an Owned Entity. We recommend requiring only an Owner to certify that it: (A) does not have knowledge of the trading decisions of an Owned Entity; (B) trades pursuant to separately developed and independent trading systems; (C) has and enforces written procedures to preclude it from having knowledge of, gaining access to, or receiving data about, trades of the Owned Entity; (D) does not share employees that control the trading decisions of the Owned Entity;[11] and (E) does not have risk management systems that permit the sharing of trades or trading strategy with the Owned Entity.

Many different legal entities, such as investment funds invest in privately-owned, state-owned and public operating companies around the globe. As a minority owner, often an Owner is not able to obtain information, such as whether an Owned Entity trades futures contracts in the U.S. or economically equivalent swaps. A minority Owner also cannot guarantee that an Owned Entity will implement policies and procedures pursuant to proposed rule 150.4(b)(2). We believe requiring an Owner to make representations on behalf of an Owned Entity, especially where an Owner does not control the Owned Entity, puts an Owner in an untenable position with respect to regulatory compliance and potentially subjects an Owner that acted in good faith to punishment.

We are also concerned that it could be very costly and burdensome for an Owner to comply with proposed rule 150.4(b)(2). While it's not clear from the Aggregation Proposal or the Supplemental Proposal whether an Owner may rely on certifications by an Owned Entity with

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Any person with an ownership or equity interest in an owned entity of 10 percent or greater (other than an interest in a pooled account subject to paragraph (b)(1) of this section), need not aggregate the accounts or positions of the owned entity with any other accounts or positions such person is required to aggregate, provided that:

(i) Such person, including any entity that such person must aggregate, and the owned entity:

(A) Do not have knowledge of the trading decisions of the other;

(B) Trade pursuant to separately developed and independent trading systems;

(C) Have and enforce written procedures to preclude each from having knowledge of, gaining access to, or receiving data about, trades of the other. Such procedures must include document routing and other procedures or security arrangements, including separate physical locations, which would maintain the independence of their activities;

(D) Do not share employees that control the trading decisions of either; and

(E) Do not have risk management systems that permit the sharing of trades or trading strategy; and

(ii) Such person complies with the requirements of paragraph (c) of this section.

[11] Consistent with the Commission's statement that the sharing between entities of attorneys, accountants, risk managers, compliance and other mid- and back-office personnel "would generally not compromise independence so long as the employees do not control, direct or participate in the entities' trading decisions." *See* Aggregation of Positions at 68,962.

respect to compliance with proposed rule 150.4(b)(2), it would seem likely that an Owner would need to rely on certifications as regular monitoring would be impractical for an Owner as an Owned Entity may not provide an Owner with such access and an Owned Entity may be physically far away.[12]

Under proposed rule 150.4(b)(2), we believe an Owner will likely need to obtain certifications from an Owned Entity, such as:

- Whether an Owned Entity trades U.S. futures contracts or economically equivalent swaps ("**U.S. derivatives**");
- If the Owned Entity trades U.S. derivatives, that it certify that it will implement the CFTC required policies and procedures and comply with CFTC disaggregation requirements; or
- If the Owned Entity does not trade U.S. derivatives, that it certify that it will not trade U.S. derivatives without first notifying the Owner and complying with CFTC regulations.

From our members' experience, it can be difficult obtaining certifications from an Owned Entity, particularly if the Owner is a passive minority Owner, or if the Owned Entity is not based in the U.S. or familiar with CFTC regulations.[13] To the extent an Owned Entity trades U.S. derivatives, such entity is under the purview of the CFTC's oversight; and as such, we believe the CFTC is in a better position to enforce compliance with its regulations, such as requiring the Owned Entity to implement policies and procedures under an aggregation exemption, than an Owner. MFA members take compliance seriously and would find it unsettling if under proposed rule 150.4(b) an Owner could do everything in its ability to comply with the aggregation exemption requirements yet be in violation due to the activity of an Owned Entity. Such rule would make a compliance program with respect to the aggregation exemption requirements very costly and difficult to enforce; and would discourage investors from investing.

MFA is confident that the Commission's objective to ensure that a person does not create an unduly large speculative position through ownership or control of multiple accounts can be achieved by requiring only an Owner to make certifications with respect to disaggregation relief and to implement and enforce written procedures to preclude the sharing of trading information with an Owned Entity. Such proposal is consistent with the very reason that relief from aggregation is needed in the first place—because the Owner does not actually control, nor perhaps is it even able to obtain certain demands from, the Owned Entity. MFA also believes such requirement would be just as effective in achieving the policy objectives as proposed rule 150.4(b)(2), but would be more cost-effective as it would greatly reduce the cost and compliance burdens associated with complying with the Commission's position limits regulations; and minimize barriers for the efficient allocation of capital and investment in the U.S. and abroad. MFA recommends that the Commission modify proposed rule 150.4(b)(2) to require only an

[12] If the Commission adopts proposed rule 150.4(b)(2) as proposed, MFA believes it will be important for the Commission to clarify that an Owner seeking disaggregation relief may rely on certifications from an Owned Entity.

[13] For example, National Futures Association ("**NFA**") members commonly report difficulty with obtaining certifications from foreign investors or counterparts, for purposes of NFA Bylaw 1101, that they are either registered or exempt from registration with the CFTC.

Owner to make certifications outlined above with respect to disaggregation relief and to implement and enforce written procedures to preclude the sharing of trading information with an Owned Entity.

C. MFA Recommends Amending the Aggregation Exemption to Take Into Account Subsequent Rule Amendments to Rule 4.13 and Changes in the Commodity Pool Industry

MFA is concerned that CFTC Rule 150.4(c)(3), which has been proposed substantially the same as proposed rule 150.4(b)(1)(iii), is overly broad, does not accommodate many pool participants who cannot aggregate positions across pools in which they have an interest, and does not reflect subsequent changes to the Commission's regulations or the commodity pool industry. The proposed Commission rule provides for exemptive relief from aggregation for limited partners, limited members, shareholders or other similar types of pool participants, with certain conditions.[14] One such condition is that such person applying for relief may not have a direct or indirect 25 percent or greater ownership or equity interest in a commodity pool where the operator of the pool is exempt from registration under CFTC Rule 4.13.[15] Due to the Commission's subsequent amendments to Rule 4.13 and changes in the commodity pool industry, many pool participants that have a 25 percent or greater interest in a Rule 4.13(a)(3) pool cannot aggregate their positions across commodity pools or accounts because they don't control the pool and they don't have position level data. Unfortunately, in its current form, proposed rule 150.4(b)(1)(iii) requires aggregation of such positions. However, these passive participants are unlikely to raise the type of concerns, which the Commissions aggregation exemption is meant to address. We believe the Commission should amend proposed rule 150.4(b)(1)(iii) to only apply to participants in Rule 4.13(a)(1) and (2) pools, as the rule originally intended.

1. A limited partner, limited member, shareholder or other passive participant in a Rule 4.13(a)(3) pool does not possess the ability to control or direct the owned entity's trading decisions.

When an owner is a passive owner of a Rule 4.13(a)(3) pool, it should not be required to aggregate positions, regardless of such owner's ownership interest. A limited partner, limited member, shareholder or other passive pool participant has only a *passive* investment and, as a result does not possess the ability to control or direct the owned entity's trading decisions. The CFTC has already acknowledged this approach by generally not requiring aggregation of positions by a passive investor in a commodity pool.[16] Moreover, a pool that relies on Rule 4.13(a)(3), by

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[14] 17 C.F.R. 150.4(c).

[15] *Cf.* proposed rule 150.4(b)(1)(iii) *with* 17 C.F.R. 150.4(c)(3), *Ownership by limited partners, shareholders or other pool participants*.

[16] For example, a passive investor in a pool of a registered operator is generally not required to aggregate the positions of this pool with the positions of other accounts or pools, even in situations where the investor holds significantly more than 25 percent. This is despite the fact that such pool could provide significantly more exposure to futures positions than a Rule 4.13(a)(3) pool could. *See infra* Note 17.

its very nature is only allowed to invest in a *de minimis* amount of commodity interests, *i.e.*, a 5% initial margin limitation, or a 100% net notional value limitation, which should protect against concerns about excessive speculation by such funds.[17]

In the case of a private fund-of-funds[18] that has a 25 percent or greater investment in an investee fund/pool that is a Rule 4.13(a)(3) pool, investment managers of underlying investee funds/pools generally never provide a manager of a fund-of-funds with the type of detailed portfolio information that such manager would need to monitor compliance with the aggregation rules. To the extent a fund-of-funds receives portfolio information, it tends to be on a delayed basis by at least one month, and not at the position level detail. In fact, in response to a request[19] by MFA and the Investment Adviser Association relating to registration and exemption questions in the fund-of-funds context, the Commission acknowledged this problem. The Commission noted that, for a manager of a fund-of-funds, there may be a "lack of visibility…regarding the positions of an Investee Fund" and that "such opaqueness" may not allow such manager to perform the direct calculations required to determine whether it qualifies for an exemption from commodity pool operator ("**CPO**") registration.[20] For purposes of the aggregation of accounts exemption, however, the fund-of-funds context and many other Rule 4.13(a)(3) pool arrangements provide for an ideal set-up for providing disaggregation relief as the investee funds/pools in which an investor invests are generally independently managed, and thus, would naturally satisfy the criteria under proposed rule 150.4(b)(2).

Besides the fund-of-funds circumstance, however, many other institutional investors often have a 25 percent or greater investment in a Rule 4.13(a)(3) pool of which they have no control over the trading and do not have the ability to monitor or affect positions. Such investors may have a greater ownership interest in a pool for a number of reasons, such as they are providing seed or start-up investment, they are an early investor, for risk management and/or accounting reasons they have requested for assets to be traded in a managed account *pari passu* to a pool, or for Employee Retirement Income Security Act ("**ERISA**") or other regulatory reasons. In certain situations, institutional investors specifically limit their investment in a Rule 4.13(a)(3) pool to avoid a situation where the investor would be above 25 percent and have to address the difficulties of obtaining position level detail on a regular basis.

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[17] While a Rule 4.13(a)(3) pool could still take a significant futures position, particularly in commodity contracts that have relatively low margin requirements, excessive speculation would still be difficult, if not impossible for pools staying below a *de minimis* threshold.

[18] We refer to a private fund-of-funds as a privately-offered fund that invests in other privately-offered funds. Such products are generally used by sophisticated investors as diversification tools.

[19] MFA and Investment Adviser Association, Request for Delayed Compliance Date of Amended Part 4; Former Appendix A of the CFTC's Part 4 Regulations, 17 CFR Part 4 (Nov. 9, 2012), *available at* https://www.managedfunds.org/wp-content/uploads/2012/11/IAA-MFA-Comment-Letter-to-CFTC-re-Extension-of-Compliance-Date-of-Former-Appendix-A-11-9-12.pdf.

[20] MFA and Investment Adviser Association, CFTC No-Action Letter (Nov. 29, 2012), *available at* http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/12-38.pdf.

In the above mentioned situations, institutional investors do not have access to the detailed position level data they would need to monitor for position limits, nor do they have the capability to monitor all of their passive investments in real-time for position limits. However, as a passive investor in a pool (whose operator and manager is unaffiliated with the investor), including pools operating pursuant to Rule 4.13(a)(3), has no investment control over the pool in which it invests, nor position level transparency in the underlying pool that trades a *de minimis* level of commodity interests; such investor is highly unlikely to able to distort or manipulate the market with respect to excessive speculative positions.

2. Rule 150.4(b)(1)(iii) should be amended to reflect the subsequent amendments to Rule 4.13 and changes in the commodity pool industry.

The Commission should amend the aggregation requirement in proposed rule 150.4(b)(1)(iii) with respect to Rule 4.13 as the Commission subsequently amended Rule 4.13 after adopting this provision in 1999 and the original concerns with respect to Rule 4.13 operators were only applicable to Rule 4.13(a)(1) and (2) exempt operators. MFA believes proposed rule 150.4(b)(1)(iii) should be amended to reflect subsequent changes to Rule 4.13 and changes in the commodity pool industry.

In 1999, when the Commission adopted the aggregation of accounts exemption in Rule 150.4 in its current form,[21] Rule 4.13 only exempted from registration as a CPO: (1) single-pool operators; and (2) operators of pools with 15 or fewer participants that had no more than $400,000 in total capital contributions.[22] The Commission in both its proposing release and adopting release stated that it was concerned with "trading by single-investor commodity pools" and that it believed "the likelihood that limited partners may be involved to some degree in the trading decisions of the partnership's trading activity rises as the overall number of limited partners in a commodity pool decreases, such as in the single or limited-number investor pool or when a small number of limited partners have a relatively dominant ownership interest."[23] The Commission stated that it did not intend for its concern with certain limited partners "to modify the general treatment of limited partners or shareholders in typical commodity pools;"[24] and that it did not find evidence of questionable trading patterns "where the CPO was registered with the Commission or where greater than 25% ownership interest was the result of a seed money or start up investment."[25] As such, in 1999 the Commission adopted Rule 150.4 to require limited partners and other similar

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[21] *See* Revision of Federal Speculative Position Limits and Associated Rules, 64 Fed. Reg. 24,038 (May 5, 1999) (hereinafter "**Rule 150.4 Adopting Release**"), available at: http://www.gpo.gov/fdsys/pkg/FR-1999-05-05/pdf/99-11066.pdf.

[22] *See, e.g.*, Additional Registration and Other Regulatory Relief for Commodity Pool Operators and Commodity Trading Advisors, 68 Fed. Reg. 47221 (Aug. 8, 2003), available at: http://www.gpo.gov/fdsys/pkg/FR-2003-08-08/pdf/03-20094.pdf.

[23] *See* Proposed Revision of Federal Speculative Position Limits and Associated Rules, 63 Fed. Reg. 38,525 at 38,532 (July 17, 1998) (hereinafter "**Rule 150.4 Proposing Release**"), and Rule 150.4 Adopting Release at 24,044.

[24] Rule 150.4 Adopting Release at 24,044.

[25] *Id.*

types of pool participants that own 25 percent or more of a pool operated by a Rule 4.13 exempt pool operator to aggregate the positions of the pool with all other positions owned or controlled by that trader.[26]

Since the Commission adopted Rule 150.4 in its current form in 1999, Rule 4.13 has undergone a number of amendments and the commodity pool industry has dramatically changed. In 2003, the Commission amended Rule 4.13 by adding two additional CPO registration exemptions (*i.e.*, new Rule 4.13 exemptions that did not exist at the time the Rule 4.13 25 percent aggregation rule was implemented).[27] Rule 4.13(a)(3) provided an exemption from CPO registration for an operator of a pool that trades a *de minimis* level of commodity interests and consists of sophisticated participants.[28] Rule 4.13(a)(4) provided an exemption from CPO registration for an operator of a pool whose participants were highly sophisticated.[29] In 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act amended the definition of a commodity interest to include swaps.[30] By defining commodity interests to include swaps, thousands of legal entities previously not considered to be commodity pools became commodity pools. In addition, in 2012, the Commission adopted further amendments to Part 4, including the rescission of Rule 4.13(a)(4).[31] As a consequence, many more entities are now considered CPOs and must either register as CPOs with the Commission or file an exemption for registration, if applicable.

MFA believes that limited partners, limited members, shareholders or other passive pool participants that own 25 percent of more of a Rule 4.13(a)(3) pool should be eligible for the aggregation of accounts exemption on the same basis as other passive pool participants as such persons do not share the same patterns of pool formation or trading characteristics as "single or limited-number investor pools"—*i.e.*, Rule 4.13(a)(1) and (2) pools—with which the Commission was concerned.[32] Moreover, pursuant to NFA's database, NFA has received about 23,000 filings for exemptions under Rule 4.13(a)(3), while it has received only approximately 850 filings under Rules 4.13(a)(1) and (2) combined. Thus, a rule which was initially drafted with the intention of only affecting a handful of firms (*i.e.*, Rules 4.13(a)(1) and (2) pools) is now—perhaps

[26] *Id.*

[27] Additional Registration and Other Regulatory Relief for Commodity Pool Operators and Commodity Trading Advisors, 68 Fed. Reg. 47,221 (Aug. 8, 2003).

[28] *Id.* at 47,224.

[29] *Id.* at 47,225.

[30] Pub.L. 111-203 (July 21, 2010).

[31] Commodity Pool Operators and Commodity Trading Advisors: Compliance Obligations, 77 Fed. Reg. 11252 (Feb. 24, 2012), available at: http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2012-3390a.pdf.

[32] Rule 150.4 Proposing Release at 38,532.

inadvertently—affecting an additional 23,000 firms that do not possess the traits identified by Commission staff in 1999 that warrant aggregation.[33]

Given the subsequent amendments to Rule 4.13 and the changes in the commodity pool industry since the original adoption of Rule 150.4, MFA believes it is appropriate to narrow the scope of proposed rule 150.4(b)(iii) to match the Commission's original objective behind such provision. Accordingly, MFA recommends that the Commission amend proposed rule 150.4(b)(iii) to apply only to participants that have a 25 percent or greater ownership in a pool, the operator of which is exempt from registration under section 4.13(a)(1) or (2), provided that a participant in a section 4.13(a)(3) pool does not have knowledge of the trading decisions of the pool.

D. MFA Recommends Amending the Rule 150.1 Definition of "Eligible Entity" and "Independent Account Controller" to Expand the Classes of Entities Eligible for the Exemption to Reflect Industry Changes Regarding the Professional Management of Trading Funds

In 1998, the Commission proposed the aggregation of accounts exemption to "better reflect the continuing trend to greater complexity in the structure of financial services companies" and "to expand the classes of entities [that would be] eligible for the exemption in response to the continuing trend toward greater professional management of trading funds."[34] Since 1998, the hedge fund industry has grown to more than $3 trillion and diversified in ways to better serve investors. As discussed above, statutory and regulatory changes brought a significant influx of "newly" defined commodity pools with diverse trading strategies (*e.g.*, hedge funds, securitizations, private equity funds, fund-of-funds, real estate investment funds, etc.), CPOs and commodity trading advisors ("**CTAs**"), including operators/advisors exempt or excluded from registration. As such, MFA believes that the definitions under Rule 150.1 should be updated to reflect the industry changes.

MFA recommends that the Commission amend the definitions of the terms "Eligible entity" and "Independent account controller" to include: a CPO; a CPO exempt from registration; an operator excluded from the definition of CPO; a limited partner, a limited member, shareholder or other pool participant of a pool whose operator is either registered or exempt from registration; a CTA; a CTA that is exempt from registration; or a person that is excluded from the definition of

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[33] We note that the independent account controller exemption (the "**IAC**) under Rule 150.3 may be helpful for some participants of Rule 4.13(a)(3) pools, but is still limited in its effectiveness:

1. The IAC does not provide a full exemption and in the past, designated contract markets such as ICE Futures U.S. placed additional restrictions on the IAC, not permitting its use for contracts such as Cotton No. 2. While those restrictions are not currently in place, they may still be implemented in the futures; and
2. As discussed in Section D, the IAC has not been amended to take into consideration new financial structures.

[34] Rule 150.4 Proposing Release at 38,532.

CTA; or a general partner, managing member or manager of a commodity pool whose operator is either registered, exempt from registration, or excluded from the definition of CPO.[35]

*   *   *   *   *

MFA appreciates the opportunity to offer suggestions to the Supplemental Proposal and the Aggregation Proposal. We would be happy to discuss our comments or any other issues raised in either proposal at greater length with the Commission or its staff. If the staff has any questions, please do not hesitate to contact Jennifer Han or the undersigned at (202) 730-2600.

Respectfully submitted,

/s/ Stuart J. Kaswell

Stuart J. Kaswell
Executive Vice President & Managing Director,
General Counsel

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[35] *See* Supplemental Proposal at 58,378-9. Proposed rule 150.1 provides:

(d) *Eligible entity* means a commodity pool operator; the operator of a trading vehicle which is excluded, or which itself has qualified for exclusion from the definition of the term “pool” or “commodity pool operator,” respectively, under § 4.5 of this chapter; the limited partner, limited member or shareholder in a commodity pool the operator of which is exempt from registration under § 4.13 of this chapter; a commodity trading advisor; a bank or trust company; a savings association; an insurance company; or the separately organized affiliates of any of the above entities:

(1) Which authorizes…..

(2)Which maintains: (i) . . .; or (2) If a limited partner, limited member or shareholder of a commodity pool the operator of which is exempt from registration under § 4.13 of this chapter, only such limited control as is consistent with its status.

(e) *Independent account controller* means a person – [(1) . . . (4)]

(5) Who is (i) Registered as a futures commission merchant, an introducing broker, a commodity trading advisor, or an associated person of any such registrant, or (ii) A general partner, managing member or manager of a commodity pool the operator of which is excluded from registration under § 4.5(a)(4) of this chapter or § 4.13 of this chapter, provided that such general partner, managing member or manager complies with the requirements of § 150.4(c).

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| asset management group

November 13, 2015

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

Re: Supplemental Notice of Proposed Rulemaking – Aggregation of Positions (RIN 3038-AD82)

The Asset Management Group ("AMG")[1] of the Securities Industry and Financial Markets Association ("SIFMA") appreciates the opportunity to provide the Commodity Futures Trading Commission ("Commission") with comments regarding the Commission's Supplemental Notice of Proposed Rulemaking on "Aggregation of Positions" ("Supplemental Aggregation NPRM").[2]

AMG members have a significant interest in the Commission's aggregation requirements for speculative position limits due to the impact these requirements can have on both asset managers' and their clients' ability to operationalize compliance with position limits and the related burdens that can diminish investors' returns. To date, we have actively participated in the Commission's public processes regarding its position aggregation proposal (the "Proposal"), including by: 1) submitting a comment letter on the initial proposed rulemaking on aggregation ("Initial Aggregation NPRM");[3] 2) serving on the Aggregation Panel at the staff's public Roundtable on position limits held on June 19, 2014; and 3) submitting a second comment letter to respond in greater detail to questions that were asked of the Aggregation Panel during the Roundtable.[4] AMG submits this letter to provide further comment on the impact of the proposed aggregation requirements, as modified by the Supplemental Aggregation NPRM, on asset managers and their clients.

[1] AMG's members represent U.S. asset management firms whose combined assets under management exceed $30 trillion. The clients of AMG member firms include, among others, registered investment companies, endowments, state and local government pension funds, private sector Employee Retirement Income Security Act of 1974 pension funds, undertakings for collective investments in transferable securities ("UCITS") and private funds such as hedge funds and private equity funds.

[2] *Aggregation of Positions,* 80 Fed. Reg. 58,365 (Sept. 29, 2015).

[3] *Aggregation of Positions,* 78 Fed. Reg. 68,946 (Nov. 15, 2013).

[4] A copy of AMG's first comment letter on the Initial Aggregation NPRM, filed on February 10, 2014 ("First AMG Aggregation Letter"), and its second comment letter after the staff Roundtable, filed on August 1, 2014 ("Second AMG Aggregation Letter"), are enclosed for convenience.

AMG commends the Commission for proposing in the Supplemental Aggregation NPRM the positive step of applying the same requirements for disaggregating positions of an owned entity regardless of whether the ownership interest is more or less than 50%. We appreciate the Commission's receptivity to comments voiced by AMG and others that the originally proposed disaggregation requirements for ownership interests greater than 50% were unworkable and ill-advised.

Nevertheless, AMG continues to have concerns about the Commission's proposed position aggregation requirements as applied to passive investors. In particular, we believe that: 1) the Commission should harmonize its aggregation requirements for passive investors across the various types of entities in which they invest; 2) the Commission should not adopt the "owned entity aggregation requirement" as currently proposed in the Supplemental Aggregation NPRM;[5] 3) if the Commission does adopt the proposed owned entity aggregation requirement, it also should revise and clarify certain aspects of the exemption that, if satisfied, permits disaggregation of an owned entity's positions; and 4) the Commission should consider other of its aggregation exemptions that raise similar concerns as the owned entity exemption.

AMG's recommended changes to the aggregation requirements are needed to avoid negative operational consequences and costs that would ultimately be detrimental to asset managers' clients. As discussed further below, these burdens imposed upon *passive investors* would not advance the Commission's purpose of imposing position limits—namely, to help prevent *coordinated trading* that could yield excessive speculation and unwarranted price changes.

I. The Commission Should Harmonize its Position Aggregation Requirements as Applied to Passive Investments Across Entity Types

As we have explained in our First and Second AMG Aggregation Letters, it is critical to remember that, in terms of equity interests in other entities, AMG's members manage the funds of *passive* investors. AMG's members act in a fiduciary capacity for investment vehicles in which these passive investors have interests, including, without limitation, registered and private commodity pools and other investment vehicles, pension funds and other institutional clients of asset managers. The entities in which these passive investors may have an ownership interest include: 1) entities other than commodity pools, such as operating companies (hereafter referred to as "owned entities"); 2) non-exempt commodity pools; and 3) a subset of commodity pools

[5] In the First and Second AMG Aggregation Letters, AMG urged the Commission, among other things, to extend the owned entity exemption of proposed rule 150.4(b)(2) to include ownership interests greater than 50% that do not involve actual common trading control, and we welcome the Commission's decision to make that proposal in the Supplemental Aggregation NPRM. *See* 80 Fed. Reg. at 58,369 and n.42. However, the prior AMG Aggregation Letters objected to the proposed owned entity aggregation requirement for passive investors in the first instance, and discussed several other issues and made several other recommendations that were not addressed in the Supplemental Aggregation NPRM. These issues and recommendations are the primary focus of this letter.

that are operated by commodity pool operators ("CPOs") that are exempt from registration with the Commission under Rule 4.13 ("Rule 4.13 exempt pools").

In each instance, these passive investors have no control over, nor any real-time knowledge of, the specific commodity derivatives trading activities of the entities in which they have invested. And yet, as currently structured in light of the Supplemental Aggregation NPRM, these passive investors: 1) under proposed rule 150.4(b)(2), must aggregate positions of owned entities when their ownership interest meets or exceeds 10%, unless they submit a filing and certification of trading independence under the owned entity exemption; 2) under proposed rule 150.4(b)(1), if they are unaffiliated with the CPO, need not aggregate positions of non-exempt commodity pools under any circumstances;[6] and 3) under proposed rule 150.4(b)(1)(iii), must aggregate positions of a Rule 4.13 exempt pool when their ownership interest meets or exceeds 25% without exception.

Requiring passive investors to aggregate the positions of owned entities at a 10% or greater ownership interest, or the positions of Rule 4.13 exempt pools at a 25% or greater ownership interest, imposes significant costs. These costs inherently and unnecessarily diminish their ability to provide valuable capital investment and generate returns for their beneficiaries and participants.

Accordingly, as we have previously commented, passive investors should not be subject to such starkly different position aggregation requirements depending on the type of entity in which they invest. Passive investors in owned entities and passive investors in Rule 4.13 exempt pools should be treated the same as unaffiliated passive investors in non-exempt pools – namely, they should not be required to aggregate, and they should not have to make a filing with the Commission as a condition of such disaggregation.

As discussed in our First AMG Aggregation Letter, such harmonization of aggregation requirements can be achieved by:

Excluding from Aggregation Requirements Passive Investors in Owned Entities, Similar to the Commission's Exclusion for Unaffiliated Passive Investors in Non-Exempt Pools. Under proposed rule 150.4(b)(1), which mirrors current rule 150.4(c), unaffiliated limited partners, shareholders and other similar types of participants in non-exempt pools (as well as limited members under the proposed rule) need not aggregate the pool's positions with their own positions, and are not required to make any filing with the Commission in order to rely on this disaggregation exemption. We do not believe there is a meaningful difference between unaffiliated passive investors in non-exempt pools and passive investors in owned entities in terms of whether a filing should be required to establish that these investors have no ability to influence trading decisions. Therefore, passive investors in owned entities should be treated the same as unaffiliated passive non-exempt pool participants by permitting them to disaggregate the

[6] Similar to owned entities, under proposed rules 150.4(1)(i) and (ii), a 10% or greater owner in a non-exempt commodity pool must aggregate the positions of the pool if it is the CPO, or if it is a principal or affiliate of the CPO unless it submits a filing and certification of trading independence.

positions of those owned entities without requiring a filing with the Commission in order to do so.[7]

Likewise, Excluding from Aggregation Requirements Passive Investors in Rule 4.13 Exempt Pools. The Commission should revise proposed rule 150.4(b)(1)(iii), which is identical to current rule 150.4(c)(3), to require passive investors to aggregate positions of a Rule 4.13 exempt pool based on a 25% or more ownership interest only when "the operator of [the pool] is exempt from registration *<u>under §§ 4.13(a)(1) or (a)(2).</u>*" The rationale for the current rule was that when there are "10 or fewer limited partners or when a limited partner has an ownership interest of 25% or greater, the limited partner" should be required to aggregate the positions of the pool.[8] The Commission was particularly concerned about single-investor pools when it adopted this requirement.[9] The only sub-paragraphs of current rule 4.13 that encompass the intended targets of this provision are sub-paragraphs (a)(1) and (a)(2). Further, exempt pools under sub-paragraph (a)(3) of rule 4.13, by definition, have only a de minimis amount of swaps and futures activity, which makes it counter-intuitive that passive investors in such pools be subjected to the strictest aggregation requirement. Accordingly, we recommend that the Commission revise proposed rule 150.4(b)(1)(iii) to apply to pools "the operator of which is exempt from registration *<u>under §§ 4.13(a)(1) or (a)(2)</u>*" in order for this requirement to apply to its intended targets.[10]

II. The Commission Should Not Require Passive Investors of Owned Entities to Aggregate Positions When They Do Not Have Actual Control Over the Owned Entities' Trading

As discussed above, passive investors in owned entities should be permitted to disaggregate the positions of those owned entities without requiring a filing with the Commission in order to do so. As discussed below, the Commission has recognized in the Supplemental Aggregation NPRM that aggregation should be required based solely on actual

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[7] First AMG Aggregation Letter at 4-6.

[8] *Revision of Federal Speculative Position Limits and Associated Rules*, 64 Fed. Reg. 24,038, 24,044 (May 5, 1999).

[9] *Id.*

[10] First AMG Aggregation Letter at 13.

In our First AMG Aggregation Letter, we also recommended that the Commission: 1) not adopt the requirement in proposed rule 150.4(a)(2) to aggregate investments in funds that follow "substantially identical trading strategies" regardless of common trading control, significant ownership, or even knowledge of the relevant investments on the basis that this proposal is vague and unworkable in practice, and lacks sufficient statutory, policy, and cost-benefit rationale (First AMG Aggregation Letter at 13-14); and 2) extend "independent account controller" eligibility to registered CPOs, exempt CPOs, and exempt and excluded commodity trading advisors (First AMG Aggregation Letter at 15). We renew these recommendations here.

control over trading, and passive investors simply have no such control. Imposing an aggregation requirement on passive investors in owned entities creates practical issues that render compliance overly burdensome, if not impossible, and is unwarranted to achieve the objectives that the Commission's aggregation rules are designed to achieve.

A. The Proposal Improperly Equates Ownership with Control, Creating Practical Issues that Render Compliance by Passive Investors Overly Burdensome, If Not Impossible

We commend the Commission for acknowledging in the Supplemental Aggregation NPRM that, as AMG has argued, aggregation of another entity's derivatives positions should be based on control over the trading of those positions:

> The Commission believes that, on balance, the overall purpose of the position limits regime (to diminish the burden of excessive speculation which may cause unwarranted changes in commodity prices) would be better served by focusing the aggregation requirement on situations where the owner is, in view of the circumstances, actually able to control the trading of the owned entity. The Commission reasons that the ability to cause unwarranted changes in the price of a commodity derivatives contract would result from the owner's control of the owned entity's trading activity.[11]

Notwithstanding this acknowledgement, however, the Supplemental Aggregation NPRM does not propose to limit the aggregation requirement with respect to owned entities to "situations where the owner is, in view of the circumstances, actually able to control the trading of the owned entity." Rather, it proposes to presume control and therefore require a person to aggregate an owned entity's positions based solely on the fact of ownership (at or above 10%) – and then to place the burden on the person to establish that there is no actual control over trading through a filing with the Commission that includes a certification that all five conditions of disaggregation set out in proposed rule 150.4(b)(2)[12] have been met:

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[11] 80 Fed. Reg. at 58,371 (footnote omitted).

[12] Under proposed rule 150.4(b)(2), the owned entity exemption must be established by a filing that includes a description of the relevant circumstances that warrant disaggregation, and a certification by a senior officer that the five conditions of the owned entity exemption have been met. Those conditions are that the owner and the owned entity: 1) do not have knowledge of the trading decisions of the other; 2) trade pursuant to separately developed and independent trading systems; 3) have and enforce written procedures to preclude each from having knowledge of, gaining access to, or receiving data about, trades of the other (which procedures must include document routing and other procedures or security arrangements, including separate physical locations, which would maintain the independence of their activities); 4) do not share employees that control the trading decisions of either; and 5) do not have risk management systems that permit the sharing of trades or trading strategy. We note that a certification that these conditions have been met can be based only on the knowledge of the entity making the certification; to demand otherwise would require owners to perform due diligence on their owned entities in order to make these filings, an onerous burden that, in some circumstances, may not be possible.

> [A]ggregation would still be the "default requirement" for the owner of a 10 percent or greater interest in an owned entity, unless the conditions of proposed rule § 150.4(b)(2) are satisfied.[13]

Adopting an "aggregate unless you establish no control" approach rather than an "aggregate if you control" approach is not a distinction without a difference to AMG members. While asset managers generally would not need to aggregate customer positions managed by independent account controllers under the independent account controller ("IAC") exemption in proposed rule 150.4(b)(5), individual IAC or non-IAC asset managers often invest customer assets (either directly or through investment vehicles) in entities that trade in commodity derivatives through passive equity interests in such entities. These asset managers would be impacted, substantially and adversely, by the requirement in the Commission's proposed rule 150.4(a) that a purely passive holder of equity securities must aggregate the positions of all owned entities of which it has beneficial equity ownership of 10% or more, unless it perfects an exemption to owned entity aggregation under proposed rule 150.4(b)(2).[14]

The Commission's owned entity aggregation requirement would create a new standard of care for passive investors in owned entities: they would have to determine whether and to what extent the 10% or greater owned entity (and all of its 10% or greater owned entity affiliates) trade in commodity derivatives and if so, act to perfect an exemption. This may not even be possible for many passive investors in various circumstances because an investor may not have access to this type of detailed information about a company in which it intends to invest. For example, if a person invests in a company but does not have the right to prevent the concentration or magnification of its investment over time due to redemptions or losses, the investor's ownership interest percentage in the company (and whether it meets the 10% threshold) could change on a real-time basis without the investor's knowledge. Investors should not be held to compliance obligations that are, as a practical matter, beyond their control to fulfill.

If no exemption is available, or the owner cannot or does not receive sufficient information from the owned entity to be able to conclude that the owned entity has taken steps to formally satisfy the requirement, then the passive investor would have to obtain reliable commodity derivatives position information from the entities in which it invests, which also would have to be updated on a real-time basis, in order to ensure compliance with speculative position limits. Even if companies were willing to provide accurate and timely information upon request from investors, these passive investors would have to develop, often from scratch, costly position monitoring infrastructure and hire or train staff to apply that infrastructure to the derivatives positions of their investments in order to ensure compliance with position limits. The costs to passive investors associated with these requirements would therefore deter investment in

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[13] 80 Fed. Reg. at 58,371 (footnote omitted).

[14] Practical compliance issues similar to those discussed in this Section with respect to the Proposal's owned entity aggregation requirement confront fund investors as well. These compliance issues are discussed in Section III below.

businesses that own commodity positions, and are not offset by any commensurate benefit, especially in terms of reduced likelihood of excessive speculation.

These costs to investors are significant, yet the Proposal does not take such costs into account in its cost-benefit analysis.

B. The Proposal's Presumption that Ownership Equates with Control is Unwarranted as Applied to Passive Investors

As noted above, the Commission has recognized in the Supplemental Aggregation NPRM that the purpose of the aggregation rules is to help prevent coordinated trading that could yield the type of excessive speculation and unwarranted price changes that the speculative position limits rules are designed to address. Passive investors, regardless of the percentage of their ownership interest, do not have control over the trading decisions of such owned entities that would raise the specter of coordinated trading activity for position limits purposes.[15] Therefore, for purposes of the Commission's aggregation rules for position limits (*i.e.*, preventing coordinated trading activity that can lead to excessive speculation and unwarranted price moves), a passive ownership interest in a legal entity is not a sufficient basis for the Commission to impose an owned entity aggregation requirement.[16]

[15] Under some circumstances, when a passive investor (for example, an ERISA plan) makes an investment in an entity, the investor's fiduciary duties (for example, as created under ERISA) could entail making prudent inquiries into the trading activities and investments of the owned entity. *See Harley v. Minnesota, Mining and Manufacturing Co*., 898 F. Supp. 2d 898, 906 (D. Minn. 1999) ('[A] fiduciary is required to undertake an independent investigation into the merits of an investment and to use appropriate, prudent methods in conducting the investigation."), *aff'd*, 284 F.3d 901 (8th Cir. 2002), *cert. denied*, 537 U.S. 1106 (2003); 29 CFR 2550.404a-1(b)(2) (providing that an investment fiduciary, when evaluating an investment, must take into consideration the risk of loss associated with the investment). This fiduciary duty to prudently inquire falls far short of an opportunity for coordinated trading. The Initial Aggregation NPRM recognized this, stating that the Proposal "would generally not require aggregation solely based on knowledge that a party gains . . . when carrying out due diligence under a fiduciary duty, so long as such knowledge is not directly used to affect the entity's trading." 78 Fed, Reg. at 68,961.

[16] According to the Supplemental Aggregation NPRM, the view that "ownership of an entity is an appropriate criterion for aggregation of that entity's positions" is "supported by Congressional direction and Commission precedent from as early as 1957 and continued through 1999." 80 Fed. Reg. at 58,372 (footnote omitted). For the reasons set out in both the First and Second AMG Aggregation Letters, we continue to believe the Commission's proposed owned entity aggregation requirement exceeds the Commission's authority under the Commodity Exchange Act ("CEA"), and is an unjustified departure from the Commission's administrative precedent. AMG respectfully disagrees with the analysis of both the statutory and regulatory history concerning position aggregation in the Supplemental Aggregation NPRM. AMG has never argued that position aggregation cannot be required on the basis of ownership. AMG's argument, which the Supplemental Aggregation NPRM does not squarely address, is that ownership-based aggregation (absent trading control) must be based on ownership of a position, and not on ownership of an entity that owns a position.

In footnote no. 58, the Supplemental Aggregation NPRM offers two reasons for its presumption that ownership equates to control, and thus imposing an "aggregate unless you establish no control" approach rather than an "aggregate if you control" approach: 1) the possibility of circumvention;[17] and 2) the burden on the Commission.[18] Respectfully, AMG submits that neither of these reasons is sufficient to justify the application of an owned entity aggregation requirement to passive investors, who do not have control over owned entities by virtue of their *passive* ownership interest in those entities.

Possibility of circumvention: As noted above, the Commission itself has recognized that the public policy goals that position limits serve are impacted by trading control, not ownership. The Supplemental Aggregation NPRM speculates that some persons "may," or "could," use ownership to exert control in circumvention of the aggregation requirement.[19] Yet, neither the Initial nor the Supplemental Aggregation NPRM suggests that passive ownership of equities can be used to exert control over trading – or even explains how that might happen. This type of passive ownership is simply not an indicia of, nor does it create a risk of, control over the trading decisions of the owned entity. A general and hypothetical risk of circumvention does not justify an "aggregate unless you establish no control" approach, as opposed to an "aggregate if you control" approach, in the context of passive equity ownership.

Burden on the Commission: With respect to the potential burden on the Commission of having to apply an individualized control test, we note that the "facts and circumstances" approach abounds throughout the Commission's rules and case law.[20] The Commission has never shied away from making individual, fact-dependent determinations on such fundamental issues as whether a given transaction is a futures contract or a swap subject to its jurisdiction, and there is no reason that such an approach would be more burdensome in the context of position

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[17] 80 Fed. Reg. at 58,371 n.58 (if aggregation were required "only if the existence of control were proven, market participants may be able to use an ownership interest to directly or indirectly influence the account or positon and thereby circumvent the aggregation requirement").

[18] *Id.* (if "there were no aggregation on the basis of ownership, [the Commission] would have to apply a control test in all cases, which would pose significant administrative challenges to individually assess control across all market participants").

[19] *Id.*

[20] AMG appreciates that the Commission's limited budget and scarce resources may make a bright-line ownership percentage an attractive approach for aggregation purposes. However, for the reasons discussed in this letter and in our First AMG Aggregation Letter, such an approach is not appropriate here. The Commission historically has eschewed such bright-line tests in favor of a "facts and circumstances" approach, and has done so in its rulemakings to implement the Dodd-Frank Act as well. *See, e.g., Further Definition of "Swap," "Security-Bases Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping,* 77 Fed. Reg. 48208, 48237 (August 13, 2012) ("Product Definitions Rulemaking") ("In evaluating whether an agreement, contract, or transaction qualifies for the forward contract exclusion[] from the swap definition for nonfinancial commodities, the [Commission] will look to the specific facts and circumstances of the transaction as a whole to evaluate whether any embedded optionality operates on the price or delivery term of the contract, and whether an embedded commodity option is marketed or traded separately from the underlying contract.").

aggregation. The desire for a bright-line test does not justify painting with so broad a brush as to sweep into position aggregation passive equity holdings that are not accompanied by any trading control.

For these reasons, we believe that the Commission should not require aggregation of an owned entity's positions by passive investors that have an ownership interest in that entity but that do not actually control the trading decisions of the owned entity.

C. At a Minimum, the Disaggregation Requirements Should be Modified, Consistent with Commission Precedents

The Proposal's "aggregate unless you establish no control" approach requires a filing with the Commission, and imposes fixed conditions to disaggregate, in all investment circumstances. If the Commission determines to retain that approach with respect to passive investors, at a minimum, AMG respectfully requests that the Commission modify the prescriptive filing requirement and rigid conditions to disaggregate an owned entity's positions in the context of passive investors. We propose two alternatives to the burdensome filing requirement, both of which find precedents in rules and guidance issued by the Commission.

Non-exclusive safe harbor: The Commission could replace the mandatory filing requirement with a non-exclusive safe harbor for passive equity ownership of another entity, based on what the Commission has done in other rulemakings. In the Product Definitions Rulemaking, for example, the Commission declined to set rigid definitions of insurance products, or consumer and commercial agreements, that are excluded from the definition of the term "swap." Instead, for insurance, the Commission provided a non-exclusive safe harbor based on the nature of the product and the nature of the provider, and stated that a failure to meet any of the requirements of the safe harbor does not mean that a particular transaction is a swap.[21] Similarly, the Commission provided an interpretation as to specific types of consumer and commercial agreements that fall outside the scope of the swap definition, and stated that this interpretation "is not intended to be the exclusive means" for consumers and commercial entities to determine whether their agreements fall within the swap definition.[22] Significantly, no notice is required to be filed with the Commission, no conditions are imposed, and no certifications need be made.

The Commission could apply this same safe harbor approach to position aggregation by passive investors. The five conditions set out in proposed rule 150.4(b)(2) would represent a safe harbor; where they are satisfied by a passive investor with respect to its activities concerning an owned entity, the investor would be assured that it may disaggregate that owned entity's

[21] 77 Fed. Reg. at 48,214 ("Such an agreement, contract, or transaction will require further analysis of the applicable facts and circumstances, including the form and substance of such agreement, contract, or transaction, to determine whether it is insurance, and thus not a swap . . .").

[22] *Id.* at 48,248 ("If there is a type of agreement, contract, or transaction that is not enumerated above, or does not have all the characteristics and factors that are listed above . . . the agreement, contract, or transaction will be evaluated based on its particular facts and circumstances.").

positions from its own. Other passive investors could look to the policy objectives underlying the safe harbor (*i.e.,* assuring independence in trading) and determine that, while they may not meet every element of the safe harbor, nevertheless, their trading is independent of that of the owned entity, and they could therefore conclude that aggregation is not required. In neither event would a filing or certification be required, since the Commission, as with the safe harbors established in the Product Definitions Rulemaking, would not be undertaking to pass upon such aggregation determinations.[23]

Alternatively, under such a safe harbor approach, the Commission could still require the filing of a notice and certification (which, under the proposed rule, would be effective upon submission), but only by those passive investors that do not satisfy the safe harbor. In either event, the safe harbor approach (whether it eliminates the filing requirement for passive investors entirely or eliminates it for those passive investors that satisfy the safe harbor) would provide needed flexibility into the proposed owned entity aggregation requirement. It would account for the prospect that passive investors, viewed in the context of their facts and circumstances, do not control the trading of entities in which they invest – but may not necessarily be able to satisfy the letter of the conditions mandated in the proposal. Given the Commission's use of such non-exclusive safe harbors for the fundamental question of whether a product is subject to Commission jurisdiction, there is no reason the same approach should not be used for the question of whether a passive equity owner of an owned entity must aggregate positons for position limits purposes.

To do otherwise would not only unduly burden passive investors, but impose a shifting responsibility upon passive investors to file when they are above an ownership threshold and withdraw that filing when they fall below that threshold. As stated above, passive investors do not necessarily control their ownership percentage and would need to monitor on an ongoing basis.

Less intrusive filing requirement: If the Commission rejects the use of a non-exclusive safe harbor and insists on a filing requirement, then it should allow for a simplified, generic omnibus filing that would provide the Commission with notice that an investor intends to rely on the exemption on a going-forward basis for its passive equity investments. Here, too, there is recent Commission precedent to support such an approach.

In adopting an exemption from various swap regulations for commodity trade options, the Commission did not require commercial end users to apply the full panoply of Part 45 of the Commission's regulations in order to report their trade options – but, rather, required a more limited form of reporting in Form TO. The Commission stated that "[t]he Form TO reporting

[23] Indeed, the requirement that passive investors claiming the owned entity exemption file a description of the relevant circumstances supporting their eligibility for the exemption undermines the Proposal's stated objective of eliminating the Commission's burden to individually assess control in all cases. Either the Commission, despite its resource constraints, will be reviewing the filings and thus will still be individually assessing control with respect to passive investors even under its "aggregate unless you establish no control" approach, or it will not be reviewing them – in which case the filing is a burdensome obligation on passive investors, with no public policy benefit.

filing requirement will provide the Commission a minimally intrusive level of visibility into the unreported trade option market," and will "guide the Commission's efforts to collect additional information . . . should market circumstances dictate . . ."[24]

Similarly, if the Commission feels that it needs to know which passive investors are relying on the owned entity exemption based on their lack of control over the trading of an owned entity, the Commission should impose a "minimally intrusive level of visibility" through a simple, generic filing stating that the passive investor is relying on the exemption. Such filings, like those for trade options, would suffice to "guide" the Commission if it determined that it needed additional information in particular circumstances.[25]

III. The Commission Should Clarify Certain of the Independence Criteria

Whether the Commission retains the five criteria of independent trading control as conditions of an exemptive filing, or as a safe harbor, AMG also requests that it provide the following clarifications with respect to certain elements of those criteria:

Separately developed and independent trading systems: The second criterion of trading independence in the Proposal would require owned affiliates to "trade pursuant to separately developed and independent trading systems." The Initial Aggregation NPRM explained that this disaggregation criterion should be interpreted in accordance with the Commission's prior practices in this regard, and stated that:

> The Commission generally does not expect that this criterion would prevent an owner and an owned entity from both using the same "off-the-shelf" system that is developed by a third party. Rather, the Commission's concern is that trading systems (in particular, the parameters for trading that are applied by the systems) could be used by multiple parties who each know that the other parties are using the same trading system as well as the specific parameters used for trading and, therefore, are indirectly coordinating their trading.[26]

AMG supports this view and requests that the Commission reiterate this guidance related to the "separately developed and independent trading systems" criterion in any final rulemaking

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[24] *Commodity Options,* 77 Fed. Reg. 25,320, 25,328 (April 27, 2012). Recently, the Commission proposed to simplify trade option reporting by commercial end users even further, proposing to require that end users simply notify Commission staff by e-mail when they have entered, or intend to enter, trade options with a notional value exceeding $1 billion during the course of a calendar year. *See Trade Options,* 80 Fed. Reg. 26,200 (May 7, 2015).

[25] In response to Commissioner Giancarlo's request for comment regarding periodic filings, we strongly urge the Commission to clarify that any filing required to rely on the owned entity exemption need only be updated in the event of a material change in the originally submitted information on which that reliance is based. Such filings should not be required on a routine or periodic basis. To do so would only exacerbate the degree to which the costs associated with such a filing requirement, particularly in the case of passive investors, outweigh its benefits.

[26] 78 Fed. Reg. at 68,961-62.

adopting it as a criterion of trading independence. In addition, AMG requests that the Commission clarify that the above guidance is not limited to off-the-shelf systems or other technologies "developed by" third parties, but rather includes any in-house software or custom modules added to third-party software. Many large entities develop their own proprietary trading software or modify third-party off-the-shelf systems to support trade capture and documentation features that they may need. Once developed, the internal or third-party-modified software (but not underlying transaction data or actual positions) may be shared with, sold to, or licensed to affiliated entities. Provided that these internal systems are not used to share trading information with day-to-day trading personnel or otherwise permit coordinated trading, entities that employ such software should be eligible for the exemption from owned entity aggregation.[27]

Written procedures to preclude knowledge of, and access to, trading information: The third criterion of trading independence in the Proposal would require that the owner and the owned entity "[h]ave and enforce written procedures to preclude each from having knowledge of, gaining access to, or receiving data about, trades of the other." AMG requests that, at least with respect to passive investors, the Commission limit this criterion of trading independence to the owner, and not the owned entity, in any final rulemaking adopting it. As a practical matter, passive investors may not be able to determine and verify whether the owned entity has written procedures that are sufficient to meet the standards of this criterion, in which case they would not be able to rely on the owned entity exemption and would be required to aggregate positions. But this should not be necessary. As long as the owner has (and enforces) the requisite written procedures that preclude it from having knowledge of, gaining access to, and receiving data about, trades of the owned entity – and that maintain the independence of its trading activities from those of the owned entity – then the underlying objective of this criterion will be achieved.

Sharing of risk management systems: The fifth criterion of trading independence in the Proposal states that owned affiliates may "not have risk management systems that permit the sharing of trades or trading strategy." The Initial Aggregation NPRM explained that:

> [T]his [disaggregation] criterion generally would not prohibit sharing of information to be used only for risk management and surveillance purposes, when such information is not used for trading purposes and not shared with employees that . . . control, direct or participate in the entities' trading decisions. Thus, sharing with employees who use the information solely for risk management or compliance purposes would generally be permitted, even though those employees' risk management or compliance activities could be considered to have an "influence" on the entity's trading.[28]

AMG supports this view and requests that the Commission reiterate the above guidance related to the "risk management systems that permit the sharing of trades or trading strategy"

[27] AMG also asks that any final rulemaking adopting this criterion of trading independence reiterate the guidance in the Initial Aggregation NPRM that "routine pre- or post-trade systems to effect trading on an operational level (such as trade capture, trade risk or order-entry systems) would not, broadly speaking, have to be independently developed in order to comply" with the conditions for owned entity disaggregation." *Id.* at 68,961.

[28] *Id.* at 68,962.

criterion in any final rule adopting it. The Commission also should confirm that disaggregation is permitted notwithstanding continuous sharing of position information, so long as such information is used only for risk management and surveillance purposes and is not shared with trading personnel.

In addition, the Commission should clarify that the disaggregation exemption is available to entities that share trading and position information for risk management purposes, even if such information is shared on a real-time basis and even if the entity's risk management systems or personnel have authority to require the reduction of positions to comply with internal credit or position limits, exchange limits, or government regulations. The Commission should confirm that entities may use shared risk management services, including real-time data sharing and position reduction mechanisms, so long as they do not permit coordinated or shared trading.

IV. The Commission Should Address Similar Concerns that Apply to IACs and Fund Investors

Several of the concerns discussed above with respect to owned entity aggregation are equally applicable to other aspects of the proposed position aggregation rules as well. For example, as we noted in the First AMG Aggregation Letter, the new filing requirement to claim the IAC exemption is no more warranted than the filing requirement to claim the owned entity exemption.[29] The Commission should adhere to its historical practice of not requiring such a filing for the IAC exemption. If it chooses to change course, though, it should allow for a simplified generic, omnibus filing that would provide the Commission notice that an eligible entity intends to use the exemption on a going-forward basis consistent with the terms of the exemption.

Further, if the Commission does not modify the treatment of Rule 4.13 exempt pools as requested above, investors in Rule 4.13 exempt pools will confront some of the same burdens and difficulties in applying the aggregation requirements as owners of other entities discussed above. For example, they may not have systems or procedures in place to monitor all the information necessary to comply with position limits. In addition, an investor in such a fund may not know what percentage ownership it has in that fund, and its ownership interest may change over time due to purchases or redemptions by other investors. However, such an investor would be required to aggregate the fund's positions with its own if the fund is a Rule 4.13 exempt pool and the investor has a 25% or greater ownership interest (even if the investor has no control over the fund's trading strategies). This presents a particular burden on the first or last investors in a pooled investment vehicle, who will necessarily have greater than a 25% interest for some period of time.

Above, we have reiterated the recommendation in our First AMG Aggregation Letter that passive investors with a 25% or greater ownership interest in a Rule 4.13 exempt pool under sub-paragraph (a)(3) (as is currently the case for unaffiliated passive investors in a non-exempt pool, and as we recommend above for passive investors in owned entities), not be required to aggregate the positions of the pool. If the Commission declines this recommendation, we

[29] *See* First AMG Aggregation Letter at 15.

recommend that passive investors with a 25% or greater ownership interest in a Rule 4.13 exempt pool at least have the opportunity to obtain a disaggregation exemption by demonstrating its absence of actual trading control. And, as we recommend above with respect to passive investors in owned entities, we recommend that such a demonstration take the form of a non-exclusive safe harbor or, at a minimum, a less intrusive required filing.

Finally, because passive investors in a Rule 4.13 exempt fund may be unable to obtain information necessary to determine whether they meet the ownership threshold and are therefore required to aggregate, the Commission also should provide such investors with a reasonable period after receiving information establishing that they have crossed that threshold before subjecting them to the aggregation requirement. As noted above, passive investors should not be held to compliance obligations that, as a practical matter, are beyond their control to fulfill.

V. Recommendations

For the reasons discussed above, AMG respectfully recommends that:

1. The Commission harmonize its position aggregation requirements for passive investors by permitting passive investors with a 10% or greater ownership interest in an owned entity, and passive investors with a 25% or greater ownership interest in a Rule 4.13 exempt fund under sub-paragraph (a)(3), to disaggregate based on their lack of actual control over trading without having to make any filing or certification, as is the case for unaffiliated passive investors in non-exempt pools.

2. If final rules continue to require owned entity aggregation by passive investors,[30] and then provide an exemption when there is no trading control, the Commission revise the exemption in proposed rule 150.4(b)(2) to provide needed flexibility by making the five criteria of trading independence a safe harbor for passive investors, rather than conditions that must be satisfied in order to claim the owned entity exemption.

3. If the Commission imposes a filing requirement for passive investors to disaggregate the positions of an owned entity, it require:

[30] In the First AMG Comment Letter, we also recommended certain additional, non-exclusive changes to the proposed owned entity aggregation requirement that would reduce the cost to comply without forgoing meaningful regulatory benefit. If the Commission retains that requirement for passive investors, we renew our prior recommendations that the Commission: 1) allow for the *pro rata* allocation of positions within set bands of ownership percentages, which would be less costly for passive investors because it would provide them some proportionate degree of protection if their owned entity exceeds a position limit; and 2) permit passive investors to measure ownership interests on a predetermined basis (such as on quarterly dates), which would reduce the costs of complying with the proposed owned entity aggregation requirement and mitigate our members' concerns about disruptions to their clients' investments that could otherwise result from frequent changes in ownership interests.

a. A filing only when a passive investor seeks to disaggregate an owned entity's positions based on its facts and circumstances although it is not able to satisfy all the elements of the five criteria of trading independence; and/or

b. Only a simplified, generic omnibus filing that would provide the Commission with notice that a passive investor intends to rely on the exemption on a going-forward basis for its passive equity investments.

4. The Commission clarify the second, third, and fifth criteria establishing independent trading control in proposed rule 150.4(b)(2)(i) along the lines described above.

5. The Commission provide aggregation relief for IACs and investors in Rule 4.13 exempt pools along the lines described above.

These recommendations would present substantially reduced costs for AMG members and their clients and promote enhanced liquidity in commodity derivatives markets without diminishing the overall purposes of the position limits regime and without creating opportunities for circumvention of the aggregation requirement.[31]

* * *

For the reasons stated above, AMG recommends that the Commission not adopt the aggregation rules as proposed in light of the Supplemental Aggregation NPRM. Instead, the rules should be revised as discussed above in order to address their impact on passive investors that have no control over the specific commodity derivatives trading activities of entities – be they pools or operating companies – in which they have invested.[32]

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[31] 80 Fed. Reg. at 58,373.

[32] In addition to position aggregation issues, AMG's members also have a significant interest in, and have provided comments to the Commission regarding, other proposed amendments to the Commission's position limits rules. A copy of AMG's comment letter ("AMG Position Limits Letter") regarding the Commission's companion release, *Position Limits for Derivatives*, 78 Fed. Reg. 75,680 (Dec. 12, 2013), also is enclosed for informational purposes. AMG welcomed Chairman Massad's statement that the Commission is taking a closer look at relying on the exchanges to grant non-enumerated hedge exemptions. *See Remarks of Chairman Timothy Massad Before the Natural Gas Roundtable* (May 26, 2015), available at http://www.cftc.gov/PressRoom/Speeches/Testimony/opamassad-23. This position is consistent with the recommendation in AMG's Position Limits Letter that the Commission provide the exchanges "broader discretion" in determining exemptions, subject to Commission oversight, which would enable the exchanges "to more effectively and efficiently tailor[] these requirements to the individual commodity contract markets." AMG Position Limits Letter at 11. AMG's Position Limits Letter also urged the Commission to: 1) modify the proposed spot-month limits and withdraw or increase the non-spot-month position limit levels; 2) preserve the risk management exemption from speculative position limits; 3) grant counterparties to "commodity index contracts" an exemption for managing price risk associated with such positions; 4) exempt registered investment companies and ERISA accounts from speculative position limits; and 5) extend grandfather relief to pre-existing positions. AMG would welcome the opportunity to further discuss our comments on these issues with the Commissioners and the staff.

We appreciate your consideration of our comments. We stand ready to provide any additional information or assistance that the Commission might find useful. Should you have any questions, please do not hesitate to contact Tim Cameron at 202-962-7447 or tcameron@sifma.org, Laura Martin at 212-313-1176 or lmartin@sifma.org, or Terry Arbit at Norton Rose Fulbright at 202-662-0223 or terry.arbit@nortonrosefulbright.com.

Respectfully submitted,

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Enclosures:
1) First AMG Comment Letter Regarding Notice of Proposed Rulemaking – Aggregation of Positions (RIN 3038-AD82), February 10, 2014
2) Second AMG Comment Letter Regarding Notice of Proposed Rulemaking – Aggregation of Positions (RIN 3038-AD82), August 1, 2014
3) AMG Initial Comment Letter Regarding Notice of Proposed Rulemaking – Position Limits for Derivatives (RIN 3038-AD99), February 10, 2014

cc (w/encl):
Honorable Timothy G. Massad, Chairman
Honorable Sharon Y. Bowen, Commissioner
Honorable J. Christopher Giancarlo, Commissioner
Mr. Vincent McGonagle, Director, Division of Market Oversight
Mr. Stephen Sherrod, Senior Economist, Division of Market Oversight
Ms. Riva Spear Adriance, Senior Special Counsel, Division of Market Oversight
Mr. Jonathan Marcus, General Counsel
Mr. Mark Fajfar, Assistant General Counsel

Enclosure 1

sifma

Invested in America

| asset management group

February 10, 2014
Melissa Jurgens
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington DC 20581

Re: ***Notice of Proposed Rulemaking – Aggregation of Positions (RIN 3038-AD82)***

The Asset Management Group ("AMG")[1] of the Securities Industry and Financial Markets Association ("SIFMA") appreciates the opportunity to provide the Commodity Futures Trading Commission (the "Commission") with comments regarding the "Aggregation of Positions" proposed rulemaking ("2013 Aggregation NPRM").[2] We believe that the Commission has made some positive steps in this 2013 Aggregation NPRM, but we have some significant concerns with respect to certain aspects of the proposal, in the following areas in particular:

- ***Owned Entity Aggregation.*** The Commission should not adopt the owned entity aggregation as proposed. Requiring passive investors, which include, without limitation, registered and private commodity pools and other investment vehicles, pension funds and other institutional clients of asset managers, that have no control over, or even knowledge of, the specific commodity derivatives trading activities of owned entities they have invested in to aggregate the positions of such entities would impose significant costs that would unnecessarily diminish their ability to provide valuable capital investment and generate returns for their beneficiaries and participants, exceeds the scope of the Commission's position aggregation authority under the Commodity Exchange Act ("CEA"), and is an unwarranted departure from the Commission's historical aggregation approach. The proposed exemptions from this owned entity aggregation requirement under proposed rules 150.4(b)(2) (10 to 50% ownership) and (b)(3) (above 50% ownership) do not sufficiently address the flaws of the proposed approach to aggregating owned entity positions in the passive investment ownership context.

[1] The AMG's members represent U.S. asset management firms whose combined assets under management exceed $20 trillion. The clients of AMG member firms include, among others, registered investment companies, ERISA plans, and state and local government pension funds, many of whom invest in commodity futures, options, and swaps as part of their respective investment strategies.

[2] 78 Fed. Reg. 68,946 (Nov. 15, 2013).

- ***Investment in Accounts or Pools with "Substantially Identical Trading Strategies."*** The Commission should not adopt the aggregation requirement in proposed 150.4(a)(2) for investments in funds that follow "substantially identical trading strategies" regardless of common trading control, significant ownership, or even knowledge of the relevant investments. This proposal is vague and lacks sufficient statutory, policy, and cost-benefit rationale.

- ***Passive Investors in Commission Regulation 4.13 Exempt Pool Aggregation Requirement.*** We recommend that the Commission amend 150.4(b)(1)(iii) to only require passive investors to aggregate positions of a Commission regulation 4.13 exempt pool based on a 25% or more ownership interest when "the operator of which is exempt from registration *under §§ 4.13(a)(1) or (a)(2)*" in order for this requirement to apply to its intended targets.

- ***Independent Account Controller Exemption.*** We recommend that the Commission extend "independent account controller" eligibility to registered commodity pool operators ("CPOs"), exempt CPOs, and exempt and excluded commodity trading advisors ("CTAs"). We also question the utility of the burdensome requirement on asset managers to submit notice filings to claim the independent account controller exemption.

1. Owned Entity Aggregation

Consistent with current 17 CFR 150.4(a), under proposed 150.4(a)(1), a person would be required to aggregate "positions in accounts" in which the person "directly or indirectly" has more than a 10% ownership interest. The Commission further proposes to interpret "accounts or positions" to include "accounts or positions" of third party[3] owned entities.[4] The Commission interprets ownership of another entity, standing alone, as providing a separate and distinct basis to require aggregation of the positions owned by the owned entity, regardless of actual control of such trading accounts.[5] That is, the Commission interprets the "ownership prong" of CEA section 4a(a)(1) to apply to accounts owned by owned entities if a person has an ownership interest greater than 10% in that owned entity (and otherwise does not have trading control or have a direct ownership interest in the owned entity accounts themselves).[6]

[3] We use the term "third party" to refer to any person that is separate from another person. A person can have relationships with many types of third parties, e.g., an owned entity, an entity it does not have an ownership interest in but whose trading it controls, etc.

[4] *See* proposed 150.4(b)(2) (providing for an exemption from aggregation requirements for positions in accounts of an owned entity when the ownership interest in the owned entity is between 10 and 50% of total equity). *See also* 78 Fed. Reg. at 68,959.

[5] *Id.* citing 77 Fed. Reg. at 31,773.

[6] *Id.* ("The Commission continues to believe, as stated in the Part 151 Aggregation Proposal, that an equity or ownership interest above 50% constitutes a majority ownership or equity interest of the owned entity and is so significant as to justify aggregation under the ownership prong of Section 4a(a)(1) of the CEA.")

For the reasons set forth below, we recommend that the Commission reconsider its proposed owned entity aggregation rules. We present our specific recommendations in section 1.3 below.

1.1. Requiring passive investors that have no control over, or even knowledge of, the specific commodity derivatives trading activities of owned entities to aggregate the positions of such entities will be unduly costly.

While asset management companies would not generally need to aggregate customer positions managed by independent account controllers under proposed 150.4(b)(5)'s independent account controller ("IAC") exemption, individual IAC or non-IAC asset managers often invest customer assets (either directly or through investment vehicles) in entities that trade in commodity derivatives. Under the Commission's proposed 150.4(a), 10% or more ownership in a trading account may be sufficient to warrant aggregation. In this case, under the Commission's interpretation of the term "account,"[7] a purely passive holder of equity securities would be required to aggregate the positions of all entities of which it has beneficial equity ownership of 10% or more, unless it perfects an exemption to owned entity aggregation (most pertinently under proposed 150.4(b)(2) or (b)(3)). An arbitrary owned entity aggregation threshold at 10% ownership is vastly over-inclusive even if it is used as indicia of corporate control;[8] the Commission itself points out that corporate "control" is imputed at 50% or more ownership for the purpose of pre-merger notifications to federal regulators under the Hart–Scott–Rodino Antitrust Improvements Act.[9]

Passive investors of the type managed by AMG members do not have control over owned entities by virtue of their *passive* ownership interest in a legal entity. As such, they would typically only have minimal knowledge of these owned entities' trading positions and decisions.[10] The 2013 Aggregation NPRM would create a new standard of care for passive investors: they would have to determine whether and to what extent the owned entity (and all of its owned entity affiliates) trade in commodity derivatives and if so, act to perfect an exemption. If no exemption is available, then the passive investor would have to obtain reliable commodity

[7] We believe this reading would constitute an unexplained change from Commission administrative precedent. *See* section 1.4 below.

[8] As discussed below in section 1.7, the appropriate control standard under Commission position limits rules relates to trading control, not corporate control.

[9] 78 Fed. Reg. at 68,958, *citing* 16 CFR 801.1(b).

[10] Under some circumstances, when a passive investor (for example an Employee Retirement Income Security Act ("ERISA") plan) makes an investment in an entity, the investor's fiduciary duties (for example, as created under ERISA) could very well entail making prudent inquiries into the trading activities and investments of the owned entity. *See Harley v. Minnesota, Mining and Manufacturing Co*., 898 F. Supp. 2d 898, 906 (D. Minn. 1999) ('[A] fiduciary is required to undertake an independent investigation into the merits of an investment and to use appropriate, prudent methods in conducting the investigation."), *aff'd,* 284 F.3d 901 (8th Cir. 2002), *cert. denied*, 537 U.S. 1106 (2003); 29 CFR § 2550.404a-1(b)(2) (providing that an investment fiduciary, when evaluating an investment, must take into consideration the risk of loss associated with the investment).

derivatives position information from the entities in which it invests and is required to aggregate in order to ensure compliance with speculative position limits. In addition, these passive investors would have to develop, often from scratch, costly position monitoring infrastructure and hire or train staff to apply that infrastructure to the derivatives positions of their investments in order to ensure compliance with position limits. These costs to passive investors would deter investment in businesses that own commodity positions and are not offset by any commensurate benefit, especially in terms of reduced likelihood of excessive speculation or manipulation.

1.2. The proposed owned entity aggregation exemptions provide inadequate relief for passive investors and do nothing to further the goals Congress directed the Commission to achieve in promulgating position limits.

The Commission proposes two exemptions to the proposed general rule that requires a person to aggregate accounts owned by a third-party entity where such person has a greater than 10% ownership in the owned entity:

1. Under proposed 150.4(b)(2), the Commission proposes an aggregation exemption for ownership interests of up to 50% of an entity's equity under certain conditions. The owner and the owned entity ("Related Entities") must not have knowledge of one another's trading decisions and have in place protections to ensure independence, including: (1) enforced written procedures to prevent sharing of trading information; (2) physical separations; (3) separately developed and independent trading systems; (4) no sharing of employees that control trading decisions; and (5) no sharing of risk management systems that permit sharing of trading information or strategies before a trade is made. This exemption is effective upon submission of a notice filing under proposed 150.4(c)(1).

2. Under proposed 150.4(b)(3), the Commission proposes an aggregation exemption for ownership interests above 50% ownership under certain conditions. These conditions include all of those described above for ownership interests at and below 50% ownership, plus: (1) certification that the Related Entities' financial results are not consolidated in a financial statement pursuant to relevant accounting rules; (2) each director for the owned entity certifies that (a) all of the owned entity's positions are bona fide hedging positions, or (b) the owned entity's positions do not exceed 20% of any position limit. This exemption must be approved by the Commission or staff operating under delegated authority in order to become effective under proposed 150.4(c)(2).

These two exemptions would provide inadequate relief for passive investors and would do nothing to further the goals Congress directed the Commission to achieve in promulgating position limits.

First, while a move in the right direction, the proposed 150.4(b)(2) exemption from aggregation for ownership interests of up to 50% in the owned entity does not extend to all ownership interests and would require a burdensome notice filing in all investment circumstances, regardless of the absence of common trading control, for no apparent benefit. By

contrast, passive investors in a pool that are not affiliated with the pool operator under proposed 150.4(b)(1) would not be required to submit a notice filing to disaggregate the positions of pools in which they have invested, regardless of their ownership interest in the pool. Again, the 2013 Aggregation NPRM provides no reason why passive investors in owned entities should not have at least the same degree of deference.

Second, the proposed application-based exemption from aggregation in 150.4(b)(3) for ownership interests in excess of 50% is, as a practical matter, unworkable. Passive investors cannot plan their investment and compliance programs around a disaggregation application filing that depends on Commission approval which, even if granted, may take weeks or months to issue, while their managers may need to make immediate investment decisions.

Moreover, the conditions imposed on the proposed 150.4(b)(3) exemption seriously constrain its utility. This is particularly true of the condition prohibiting consolidation of financial results. The fact that an investor consolidates the financial results of the firms in which it invests is not indicative of trading control; earning returns on an investment is the main reason an investor invests. In addition, the requirement that the owned entity's positions not exceed 20% of any position limit effectively subjects owned entities to lower position limits.[11] The 2013 Aggregation NPRM makes no findings that this restriction furthers any of the goals Congress directed the Commission to achieve in promulgating position limits rules under CEA sections 4a(a)(2)(C) and 4a(a)(3)(B).

1.3. The Commission should reconsider its owned entity aggregation requirements.

For reasons stated in more detail in section 1.4 below, we believe the Commission's proposed owned entity aggregation requirements are legally flawed and based on an erroneous interpretation of the CEA and applicable administrative precedent. We recommend, therefore, that the Commission re-examine the 2013 Aggregation NPRM and substantially amend the proposed 150.4(b)(2) and (3) exemptions to achieve a more appropriate balance among the six statutory factors that the CEA requires the Commission to address when promulgating any position limit rules,[12] by:

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[11] The alternative requirement that all of the owned entity's positions be bona fide hedging positions is not an independent condition. CEA section 4a(c)(1) prohibits the Commission from restricting the bona fide hedging positions of any trader: "No rule, regulation, or order issued under subsection (a) of this section shall apply to transactions or positions which are shown to be bona fide hedging transactions[.]" CEA section 4a(c)(1). Therefore, the limitation that an owned entity's positions be limited entirely to bona fide hedging positions is simply a sub-set of the requirement that would restrict speculative positions up to 20% of any limit.

[12] These factors include the "goals" stated in CEA section 4a(a)(2)(C), i.e., "striv[ing] to ensure" that (Factor 1) "trading on foreign boards of trade in the same commodity will be subject to comparable limits" and (Factor 2) "that any limits to be imposed by the Commission will not cause price discovery in the commodity to shift to trading [to FBOTs]." They also include the four additional factors that CEA section 4a(a)(3)(B) directs the Commission to balance when exercising its CEA section 4a(a)(2) authority: (1) (Factor 3) to diminish, eliminate, or prevent excessive speculation causing sudden or unreasonable fluctuations or unwarranted changes in price; (2) (Factor 4) to deter and prevent market manipulation, squeezes, and corners; (3) (Factor 5) to ensure sufficient market liquidity for bona fide hedgers; and (4) (Factor 6) to ensure that the price discovery function of the underlying market is not disrupted.

1. Extending the relief provided to passive investors in commodity pools under current 150.4(c) and proposed 150.4(b)(1) to passive investors in owned entities that do not have actual trading control of the owned entity's derivatives trading; and

2. Extending the owned entity exemption at proposed 150.4(b)(2) to include all third party ownership interests (greater than 50%) that do not involve actual common trading control.

In addition, we recommend three additional, non-exclusive changes that would reduce the cost to comply without forgoing meaningful regulatory benefit under the six statutory factors referenced above:

Filing requirements: The Commission should only require a 150.4(c)(1) notice filing when there is majority ownership in addition to indicia of trading control, e.g., a common business purpose relating to derivatives trading or the commercial use of commodities. The Commission's proposed 150.4(c)(2) application procedure should be omitted altogether or reserved for instances where there is majority ownership in addition to a trading control. In any event, a passive investor that holds an equity investment of any amount in an operating company that it has no trading control over should not be required to make any type of filing. If the Commission insists on a filing requirement for passive investors, then it should allow for a simplified, generic omnibus filing that would provide the Commission with notice that a passive investor intends to use the exemption on a going-forward basis consistent with the terms of the exemption for its passive equity investments.

Pro rata attribution of positions: The Commission should allow for the *pro rata* attribution of positions based on ownership interest. *Pro rata* allocation of positions would be less costly for passive investors because it would provide them some proportionate degree of protection if their owned entity exceeds a position limit. For example, for a passive investor with a 15% ownership interest in an owned entity that exceeds a position limit, an allocation of 15% or even 25% of that owned entity's positions would reduce the risk of an inadvertent position limits overage. Accordingly, we recommend *pro rata* allocation of ownership interests within set bands of ownership percentages.

Quarterly measurement: The costs of complying with the Commission's proposed aggregation rules would also be reduced if the Commission provided a safe harbor to passive investors to measure ownership interests on a predetermined basis, such as on quarterly dates. Permitting passive investors to measure ownership interests on a fixed and workable schedule will not undermine the Commission's position limits regime. This approach would mitigate our members' concerns about disruptions to their clients' investments that could otherwise result from frequent changes in ownership interests.

These recommendations would present substantially reduced costs for AMG members and their clients yet would still ensure at least the same degree of efficacy of the Commission's position limits regime under the goals provided by Congress in CEA sections 4a(a)(2)(C) and 4a(a)(3)(B) by providing passive investors with legal certainty that would promote liquidity in

commodity derivatives. In fact, the Commission's proposal would increase the potential for coordinated manipulative trading activity because it mandates common trading control where none currently exists.

1.4. Requiring passive investors that have no control over, or knowledge of, the specific commodity derivatives trading activities of owned entities they have invested in to aggregate the positions of such entities has not been justified.

1.4.1. Requiring passive investors that have no control over, or knowledge of, the specific commodity derivatives trading activities of owned entities they have invested in to aggregate the positions of such entities exceeds the scope of the Commission's position aggregation authority under the CEA.

The 2013 Aggregation NPRM states its basis for requiring the aggregation of owned entity positions regardless of the existence of common trading control as follows (emphasis added):

> In light of the language in section 4a, its legislative history, subsequent regulatory developments, and the Commission's historical practices in this regard, the Commission continues to believe that section 4a requires aggregation on the basis of *either ownership or control of an entity*.[13]

The relevant portion of CEA section 4a(a)(1) provides (emphasis added):

> [T]he positions held and trading done by *any persons directly or indirectly controlled by such person* shall be included with the positions held and trading done by such person; and further, such limits upon positions and trading shall apply to positions held by, and trading done by, two or more persons acting pursuant to an expressed or implied agreement or understanding, the same as if the positions were held by, or the trading were done by, a single person.

CEA section 4a(a)(1), by its terms, requires aggregation of positions held and trading done by third parties only when the other person is "*directly or indirectly controlled*."[14] This is not a situation where the CEA is silent about aggregating the positions of third parties (including owned entities) so that the Commission might fill the gap by inferring that the "ownership prong" applies to positions held by an owned third party; rather, the statute specifically addresses the conditions under which a third party's positions are to be aggregated, i.e., when the positions

[13] 78 Fed. Reg. at 68,956.

[14] In the first critical clause quoted above, the phrase "any person" refers to a third party, whereas the phrase "such person" refers to the principal person subject to this statutory aggregation provision. Thus, re-phrasing the clause slightly for purposes of clarification, the positions held and trading done by a third party (e.g., the company in which an investor invests) directly or indirectly controlled by a person (e.g., the investor) shall be included with the positions held and trading done by that person (e.g., the investor). By contrast, the "ownership prong" that appears immediately after this first clause applies only to directly held positions ("positions held and trading done by such person," e.g., the investor).

held and trading done by the third party are "directly or indirectly controlled." With respect to positions held and trading done by third parties, CEA section 4a(a)(1) imposes a constraint on the Commission's authority to require aggregation. CEA section 4a(a)(1) provides that the aggregation of positions held and trading done by third parties is to occur only when the positions held and trading done by the third party are "directly or indirectly controlled" ("Third Party Aggregation Constraint").

The statutory Third Party Aggregation Constraint is consistent with the legislative history of CEA section 4a. As cited in the Commission's 2012 "Aggregation, Position Limits for Futures and Swaps" proposed rulemaking,[15] a 1968 Senate Report provides that "Section 2 of the bill amends section 4a(1) of the [CEA] to show clearly the authority to impose limits on […] trading done and positions held by *a person controlled by another* shall be considered as done or held by" a person (e.g., the investor).[16]

1.4.2. Requiring passive investors that have no control over, or knowledge of, the specific commodity derivatives trading activities of owned entities they have invested in to aggregate the positions of such entities is an unwarranted departure from the Commission's historical aggregation approach.

The Commission interprets 17 CFR 150.4(b) and proposed Commission regulation 150.4(a) as requiring the aggregation of owned entity positions.[17] The Commission, however, has never promulgated rules (that were not vacated) in which it has interpreted "accounts" to encompass accounts owned by third parties that are commonly owned but not commonly controlled. All of the Commission's pre-2011 position aggregation rulemakings required aggregation on the basis of direct ownership in accounts, not ownership interests in third parties who, in turn, own positions in derivatives trading accounts.

For example, the Commission's 1979 Statement of Aggregation Policy is squarely focused on ownership of accounts, not ownership in entities that own accounts.[18] Its first point stated that "[e]xcept for a limited partner or shareholder in a commodity pool, any person who has a 10% or more financial interest *in an account* will be considered as an account controller" (emphasis added).[19] The 1979 Statement of Aggregation Policy defines "discretionary account" as "a commodity futures trading account for which buying and/or selling orders can be placed or originated, or for which transactions can be effected…"[20]

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[15] 77 Fed. Reg. 31,767 (May 30, 2012).

[16] *Id.* at 31,772 at fn. 80, citing S. Rep No. 947, 90th Cong., 2 Sess. 5 (1968) (emphasis added).

[17] Proposed 150.4(a) ("For the purpose of applying the position limits set forth in § 150.2, unless an exemption set forth in paragraph (b) of this section applies, all positions in accounts for which any person, by power of attorney or otherwise, directly or indirectly controls trading or holds a 10% or greater ownership or equity interest, must be aggregated with the positions held and trading done by such person.").

[18] Statement of Policy on Aggregation of Accounts and Adoption of Related Reporting Rules, 44 Fed. Reg. 33,839 (Jun. 13, 1979).

[19] *Id.* at 33,845.

[20] *Id.*

The 2013 Aggregation NPRM presents the following quote from a position limits rulemaking from 1999 in an attempt to support its interpretation that CEA section 4a(a)(1)'s "ownership prong" includes ownership of third parties' accounts: "the Commission . . . interprets the 'held or controlled' criteria [of CEA section 4a] as applying separately to ownership of positions or to control of trading decisions."[21] However, this quote does not refer to accounts of owned entities. This is not surprising as, again, this 1999 rulemaking was squarely focused on the aggregation of directly owned accounts – and not of accounts owned by an owned third party. For example, the 1999 rulemaking provided that when a person "holds or has a financial interest in or controls more than one account, all such accounts shall be considered by the futures commission merchant, clearing member or foreign broker as a single account…"[22] Thus, neither the quote nor the rulemaking from 1999 support the interpretation in the 2013 Aggregation NPRM.

Contrary to the assertion of the 2013 Aggregation NPRM, the Commission has in fact clearly distinguished between ownership of accounts, on the one hand, and ownership in third party entities that themselves own accounts, on the other. In the context of its CFTC Form 40 rules at 17 CFR 18.04(a)(8), the Commission requires the reporting of information relating to "persons… who have a financial interest of 10% or more in the [Form 40] reporting trader *or* the accounts of the reporting trader" (emphasis added). If financial interests in "accounts" encompassed financial interests in accounts of other persons, then the Commission would have had no need to separately articulate the requirement to report financial interests in the accounts of a reporting trader and the requirement to report financial interests in the reporting trader itself.

The Commission's historical definition of "account" in the position aggregation context is consistent with other Commission regulations that also similarly define the term "account." For example, 17 CFR 39.2 defines "customer account" as meaning "a clearing member account held on behalf of customers, as that term is defined in this section, and which is subject to section 4d(a) or section 4d(f) of the [CEA]" and "house account" as meaning "a clearing member account which is not subject to section 4d(a) or 4d(f) of the [CEA]." 17 CFR 1.3(vv) defines "futures account" to mean an "account that is maintained in accordance with the segregation requirements of sections 4d(a) and 4d(b) of the [CEA] and the rules thereunder." None of these regulations define an "account" as encompassing accounts of owned entities.

The one exception is the Commission's definition of "proprietary account" in 17 CFR 1.3(y),[23] which is defined explicitly to include accounts held by "business affiliates."[24] This term

[21] 78 Fed. Reg. at 68,956, *quoting* Revision of Federal Speculative Position Limits and Associated Rules, 64 Fed. Reg. 24,038, 24,044 (May 5, 1999).

[22] *Id.* at 24,046.

[23] 17 CFR 1.3(y) "*Proprietary account*. This term means a commodity futures, commodity option, or swap trading account carried on the books and records of an individual, a partnership, corporation or other type of association: (1) for one of the following persons, or (2) of which ten percent or more is owned by one of the following persons, or an aggregate of ten percent or more of which is owned by more than one of the following persons:

[...]

is cited as support for the Commission's new interpretation of the term "account" in the position limits context.[25] The term "proprietary account," however, is irrelevant to the position limits context. The term "proprietary account" is used in 17 CFR 155.3, which requires that a futures commission merchant ("FCM") give priority to executing customer orders over orders from any "proprietary account." Moreover, the fact that the term "proprietary account" is explicitly defined to include accounts held by "business affiliates" suggests that in the Commission's regulations, the term "account," standing alone, does not include accounts of owned entities but rather refers only to directly held or controlled trading accounts.

Even the Commission's enforcement history reflects that it has traditionally viewed aggregation of owned entity positions as only being required where there is common derivatives trading control. The import of the Commission's Order settling an administrative enforcement action in September 2010 against Vitol Inc. and one of its affiliates for false statements in connection with NYMEX position aggregation rules (which parallel Commission rules),[26] is that control was a pre-requisite in considering whether Vitol Inc. was required to aggregate the positions of its commonly-owned affiliate.[27] The recitation of facts in the Commission's Order

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> (viii) A business affiliate that, directly or indirectly is controlled by or is under common control with, such individual, partnership, corporation or association: P*rovided, however*, That an account owned by any shareholder or member of a cooperative association of producers, within the meaning of section 6a of the [CEA], which association is registered as a futures commission merchant and carries such account on its records, shall be deemed to be an account of a customer and not a proprietary account of such association, unless the shareholder or member is an officer, director or manager of the association."

[24] 17 CFR 1.3(y)(1)(viii).

[25] 78 Fed. Reg. 68,956 citing 17 CFR 1.3(y).

[26] "Ownership of Accounts – Except as set forth in Section E. below, any person holding positions in more than one account, or holding accounts or positions in which the person by power of attorney or otherwise directly or indirectly has a 10% or greater ownership or equity interest, must aggregate all such accounts or positions unless such person is a limited partner, shareholder, member of a limited liability company, beneficiary of a trust or similar type of pool participant in a commodity pool. […]." CME Rule 559.D.2, available at http://www.cmegroup.com/rulebook/CME/I/5/5.pdf. Certain commodities are currently subject only to position limit rules set by designated contract markets ("DCMs"). Aggregation for purposes of DCM-set position limits today is governed by Core Principle 5 "Position Limitations or Accountability" in CEA section 5(d)(5) and subpart F of 17 CFR part 28. CEA section 5(d)(1)(B) provides that DCMs have "reasonable discretion in establishing the manner in which the board of trade complies with the core principles described in this subsection" unless "otherwise determined by the Commission by rule or regulation." Under 17 CFR 38.301, DCMs "must meet the requirements of parts 150 and 151 of this chapter, as applicable." The only Commission regulation that relates to the aggregation of positions for exchange-set position limits (and that was not vacated) is 17 CFR 150.5(g). 17 CFR 150.5(g) provides that DCMs must aggregate on the basis of control and does not prescribe any other standard:

> In determining whether any person has exceeded the limits established under this section, all positions in accounts for which such person by power of attorney or otherwise directly or indirectly controls trading shall be included with the positions held by such person[.]

[27] In the Matter of Vitol Inc. et al., Docket No. 10-17 (CFTC Sept. 14, 2010), available at http:// www.cftc.gov/ucm/groups/public/@lrenforcementactions/documents/legalpleading/enfvitolorder09142010.pdf. In this matter, the Commission found that Vitol Inc. and its affiliate willfully failed to correct NYMEX's misperception of the "true nature of the relationship between" Vitol Inc. and its affiliate and imposed a civil monetary penalty of $6 million.

focused on Vitol Inc.'s failure to disclose information relating to the "flow of trading information between" the affiliated entities and the "limited nature of the barriers to trading information flow between" these presumably commonly owned Vitol affiliates.[28] These facts would have been relevant only if common control were a pre-condition to the application of the position aggregation rules (as it is due to the statutory Third Party Aggregation Constraint). Tellingly, no facts relating to common ownership were included in the Order.[29]

1.4.3. The 2013 Aggregation NPRM uses an inappropriate baseline in considering the costs and benefits of its proposed owned entity aggregation rules.

In its discussion of "Cost-Benefit Considerations," the 2013 Aggregation NPRM states that its proposed owned entity aggregation policy is "more permissive than the 10% [owned entity position aggregation] threshold currently provided."[30] It therefore assumes a cost-benefit baseline that requires aggregation of positions for position limit compliance purposes based solely on ownership, regardless of the existence of common control.

This is an inappropriate baseline for two important reasons. First, as described above, neither the Commission nor DCMs (which currently are the sole administrators of position limits for all but nine agricultural commodities, including 19 of the 28 "referenced contracts"), currently require the aggregation of owned entity positions regardless of the existence of common control. Therefore, the Commission's proposal is more restrictive, not "more permissive" than (and, indeed, a dramatic departure from) the existing position aggregation regime. Second, speculative positions outside of the spot month have not been subject to position limits in 19 of the 28 "referenced contract" markets the Commission proposes to subject to position limits under an accompanying release.[31] Aggregating non-spot-month positions of entities in which passive investors make investments presents considerable new challenges, which have not been adequately considered by the 2013 Aggregation NPRM.

1.4.4. "Control" in the context of position aggregation requirements means actual control of derivatives trading, not of anything else, and therefore the owned entity aggregation requirements cannot be based on a theory of corporate control.

[28] *Id.*

[29] *See also* Order Instituting Proceedings Pursuant to Sections 6(c) and 6(d) of the Commodity Exchange Act, as Amended, Making Findings and Imposing Remedial Sanctions, at 4, http://www.cftc.gov/ucm/groups/public/@lrenforcementactions/documents/legalpleading/enfcitigroupcgmlorder092112.pdf (Sept. 21, 2012) (finding that Citigroup was liable for the position limits violation of its subsidiary Citigroup Global Markets not on the basis of owned entity aggregation requirements under 17 CFR 150.4(b), but rather on the basis of an agency theory (CEA section 2(a)(1)(B) and 17 CFR 1.2).

[30] 78 Fed. Reg. at 68,968.

[31] 78 Fed. Reg. at 75,826. AMG is commenting separately on this proposal, including proposed 150.5(a)(5) providing that aggregation requirements of exchanges must "conform to" those of the Commission under proposed 150.4.

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As noted above, the 2013 Aggregation NPRM bases its proposed owned entity aggregation rules solely on CEA section 4a(a)(1)'s "ownership prong." The 2013 Aggregation NPRM suggests in defense of the 50% ownership aggregation exemption threshold in proposed 150.4(b)(2) that an ownership interest of greater than 50% "is indicative of control" and therefore warrants aggregation of an owned entity's positions even in the absence of any actual trading control. This conclusion appears to be based on conflated notions of corporate control in other contexts with trading control in the position limits context. The Commission cites a 50% equity ownership threshold used by the Federal Trade Commission and Department of Justice as "reflect[ing] a general understanding that ownership at this level poses substantial potential for direct or indirect control over an owned entity."[32] This threshold is used by these other government agencies to identify potential instances of common corporate control for the purpose of anti-trust filing requirements, not of common derivatives trading control.[33] Speculative position limits aggregation requirements are based on whether ownership is indicative of derivatives *trading control*, not corporate control.

The Commission has traditionally interpreted "control" in CEA section 4a(a)(1) and its predecessors as control of trading, not of corporate control or any other concept of control. For example, the Commission's current IAC exemption to position aggregation requirements focuses on the controller's independent control of trading decisions and lack of knowledge of the trading decisions of any other IAC.[34] Indeed, the 2013 Aggregation NPRM appropriately models the conditions for the owned entity aggregation exemption in proposed 150.4(b)(2) on the conditions for the IAC exemption, i.e. factors that demonstrate independent trading control. Similarly, the Commission's definition of "controlled account" at 17 CFR 1.3(j) means an account for which a person "actually directs trading."[35] Perhaps most important of all, the terms of the Commission's proposal appear to focus on trading control, not corporate control. The Commission's proposed general aggregation rule (150.4) requires aggregation when a person "directly or indirectly controls *trading*."

Thus, even if the Commission were to abandon the ownership theory relied upon in the 2013 Aggregation NPRM for a control theory instead, the result is the same: the proposal provides no basis for the Commission to depart from its historical view that position aggregation is required only where actual common trading control exists, e.g., when an investor controls the derivatives trading that occurs in a an owned entity's accounts.[36]

[32] 78 Fed. Reg. at 68,958, *citing* 16 CFR 801.1(b).

[33] *See* 16 CFR 802.2.

[34] 17 CFR 150.1(e).

[35] *See also* CFTC Form 102, available at http:// www.cftc.gov/ucm/groups/public/@forms/documents/file/cftcform102.pdf (prompting FCMs and others to identify "controlled accounts" of the same advisor exceeding "special account" activity thresholds).

[36] 78 Fed. Reg. at 68,958.

2. Passive Investment in Commission Regulation 4.13 Exempt Commodity Pools

2.1. The passive 17 CFR 4.13 exempt pool investor aggregation requirement should be omitted.

The 2013 NPRM proposes to require aggregation of positions in a 17 CFR 4.13 pool when a person holds a greater than 25% ownership interest in the pool under proposed 150.4(b)(1)(iii). This proposed rule is identical to current Commission rule 150.4(c)(2)(iii). The rationale for the current rule was that when there are "10 or fewer limited partners or when a limited partner has an ownership interest of 25% or greater, the limited partner" should be required to aggregate the positions of the pool.[37] The Commission was particularly concerned about single-investor pools when it adopted this requirement.[38] The only sub-paragraphs of current 17 CFR 4.13 that encompass the intended targets of this provision are sub-paragraphs (a)(1) and (a)(2). We therefore recommend that the Commission amend 150.4(b)(1)(iii) to apply to pools "the operator of which is exempt from registration <u>*under §§ 4.13(a)(1) or (a)(2)*</u>" in order for this requirement to apply to its intended targets.

3. Investment in Accounts or Pools with "Substantially Identical Trading Strategies"

Proposed 150.4(a)(2) provides that holding or controlling trading in more than one account or pool (collectively "funds") with "substantially identical trading strategies" requires aggregation ("SITS Rule"). This requirement would apply notwithstanding any other applicable aggregation exemption. In other words, the proposed SITS Rule would apply regardless of common control, significant ownership, or even knowledge of the relevant investments in funds with "substantially identical trading strategies."

The proposed SITS Rule should be omitted from any final rulemaking because it lacks sufficient rationale and is unworkable in practice, as discussed below. In the alternative, proposed 150.4(a)(2) should be amended to apply to "any person that, by power of attorney or otherwise, ~~holds or~~ <u>directly</u> controls the trading of positions" in a SITS account or pool.

3.1. The proposed SITS Rule lacks rationale.

The Commission does not provide a statutory or policy rationale for the proposed SITS Rule in the 2013 Aggregation NPRM or its 2012 predecessor.[39] The Commission's 2011 "Position Limits for Futures and Swaps" final rulemaking did contain a short rationale for a similar requirement for investments in funds with "identical trading strategies."[40] This provision, the Commission stated, was "intended to prevent circumvention of the aggregation requirements.

[37] 64 Fed. Reg. at 24,044.

[38] *Id.*

[39] There are, however, four mentions of the "identical trading strategies" rule in footnotes to the 2012 proposal. *See* e.g., 77 Fed. Reg. at 31,769 at fn. 14.

[40] *See* vacated 151.4(d).

In [the] absence of such [an] aggregation requirement, a trader can, for example, acquire a large long-only position in a given commodity through positions in multiple pools, without exceeding the applicable position limits."[41] However, the 2011 rulemaking provided no historical example of any such circumvention.[42]

Finally, the 2013 Aggregation NPRM fails altogether to consider the costs and benefits of the aggregation requirement for investments in funds that follow "substantially identical trading strategies," despite the very real costs that such a requirement would have on investors.

3.2. The proposed SITS Rule is unworkable in practice.

As a consequence of the proposed SITS Rule, a $10,000 investor in two $1 billion commodity index mutual funds using the same index may have to aggregate the positions in those two $1 billion mutual funds because they follow "substantially identical trading strategies." To provide another example, under the proposed SITS Rule, a $10,000 investor in a fund-of-funds that, in turn, invests $10,000 in two $1 billion commodity index funds that follow "substantially identical trading strategies" would have to aggregate the positions in those two $1 billion funds – even if the investor did not know how the fund-of-funds manager allocated the investor's money. (In contrast, under proposed 150.4(b)(1)'s exemption for investors in commodity pools, it appears that if an investor made a $500 million investment in a single $1 billion commodity index pool, it would be exempt from speculative position limits altogether).

To comply with the aggregation requirement of the proposed SITS Rule, the investor in the foregoing scenarios would not only have to determine how his or her funds are being invested, but also the trading strategies of all of the relevant funds and whether they meet the undefined test of being "substantially identical." Then, he or she would need a data feed to determine the size of the commodity derivatives positions in each fund determined to be using a "substantially identical trading strategy." Such a requirement would simply be unworkable in most cases (depending on, among other things, the size of the investment, the size of the funds with "substantially identical trading strategies" that the investor's money has been invested in, and the investor's other countable commodity derivatives positions). Even if it could be done (the practical impediments described above aside, there would also be significant and costly legal and operational obstacles to overcome), to implement such a compliance program to prevent inadvertent violations of speculative position limits due to the aggregation requirement of the proposed SITS Rule, would cost many times the investor's $10,000 investments.

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[41] 76 Fed. Reg. at 71,654.

[42] The 2011 rulemaking was not very clear when it adopted an aggregation requirement for investments in accounts or pools with "identical trading strategies." Now, the 2013 Aggregation NPRM provides no guidance as to the meaning of "substantially identical trading strategies," nor does it explain how the concern about circumvention has changed from 2011 to 2013 that would explain the difference between "identical" and "substantially identical."

4. Independent Account Controller Exemption

We commend the Commission's inclusion of an IAC exemption that allows asset management companies to disaggregate the positions of customer accounts controlled by an IAC. We also commend the Commission for proposing to allow managers of employee benefit plans in proposed 150.4(b)(5) to qualify as IACs. We do have concerns, however, with two aspects of the proposed IAC exemption, described below.

4.1. The definition of IAC[43] should not be limited based upon CPO or CTA status.

The status of entities as registered, exempt or excluded CPOs or CTAs has nothing to do with the purpose behind the IAC: to provide for a safe harbor from aggregation requirements where there is no shared ownership or control between a parent advisor and sub-advisors. The Commission has not articulated a reason why IAC status should be limited to certain registrants on the one hand and certain exempt or excluded entities on the other. All pool operators and trading advisors should be able to avail themselves of the IAC exemption, irrespective of their status as registered, exempt or excluded.

4.2. The proposed IAC notice filing should not be required.

We question the utility of requiring asset managers to submit notice filings complying with proposed 150.4(c)(1) to claim the proposed 150.4(b)(5) IAC exemption. Under the Commission's current IAC exemption (17 CFR 150.3(e)), no such filing is required. The new proposed filing is unduly burdensome, particularly given the fact that we are aware of no abuses of the existing IAC exemption. In lieu of a notice filing, the Commission should consider a requirement to keep records on the eligible entity's and IAC's compliance with the conditions of the IAC exemption. If, however, the Commission requires a filing, it should allow for a simplified generic, omnibus filing that would provide the Commission notice that an eligible entity intends to use the exemption on a going-forward basis consistent with the terms of the exemption.

5. Summary

For the reasons stated above, we recommend that the Commission make the following changes in any final rulemaking adopting the 2013 Aggregation NPRM:

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[43] Proposed 150.1 defines "independent account controller" to mean a person (1) who specifically is authorized by an eligible entity, independently to control trading decisions on behalf of, but without the day-to-day direction of, the eligible entity; (2) over whose trading the eligible entity maintains only such minimum control as is consistent with its fiduciary responsibilities for managed positions and accounts to fulfill its duty to supervise diligently the trading done on its behalf or as is consistent with such other legal rights or obligations that may be incumbent upon the eligible entry to fulfill; (3) who trades independently of the eligible entity and of any other IAC trading for the eligible entity; (4) who has no knowledge of trading decisions by any other IAC; and (5) who is (i) registered as an FCM, an introducing broker, a CTA, or an associated person of any such registrant, or (ii) a general partner, managing member or manager of a commodity pool the operator of which is excluded from registration under Rule 4.5 or 4.13.

- The Commission should not adopt the proposed owned entity aggregation as proposed. Instead, the rules should be amended as discussed above in order to address the impact on passive investors that have no control over, or even knowledge of, the specific commodity derivatives trading activities of owned entities in which they have invested.

- The Commission should amend 150.4(b)(1)(iii) to only require passive investors to aggregate positions of a Commission regulation 4.13 exempt pool based on a 25% or more ownership interest when "the operator of which is exempt from registration *under §§ 4.13(a)(1) or (a)(2)*."

- The Commission should omit the requirement to aggregate investments in funds that follow "substantially identical trading strategies" from any final rulemaking.

- The Commission should expand the scope of entities eligible to become IACs, so no distinction is made based upon CPO or CTA registration, exemption or exclusion status. In addition, the IAC notice filing requirements should be eliminated.

*   *   *

We appreciate your consideration of our comments. We stand ready to provide any additional information or assistance that the Commission might find useful. Should you have any questions, please do not hesitate to contact Matt Nevins at 212-313-1176 or Michael Loesch at 202-662-4552.

Sincerely,

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Enclosure 2

August 1, 2014

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Re: Notice of Proposed Rulemaking – Aggregation of Positions (RIN 3038-AD82)

The Asset Management Group ("AMG")[1] of the Securities Industry and Financial Markets Association ("SIFMA") appreciates the opportunity to provide the Commodity Futures Trading Commission (the "Commission") with supplemental comments regarding the "Aggregation of Positions" proposed rulemaking ("2013 Aggregation NPRM").[2] As asset managers, AMG members have a significant interest and unique perspective in the Commission's proposed aggregation requirements for purposes of applying speculative position limit rules. We appreciate the opportunity to have participated in the Aggregation Panel at the staff's public Roundtable on position limits for physical commodity derivatives held on June 19, 2014 (the "Roundtable").

We are writing this supplemental comment letter to provide further detail on some of the questions that were raised during the Aggregation Panel of the Roundtable[3] and to recap briefly the main concerns expressed by AMG during the Roundtable and in our initial comment letter on the 2013 Aggregation NPRM.[4]

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[1] The AMG's members represent U.S. asset management firms whose combined assets under management exceed $30 trillion. The clients of AMG member firms include, among others, registered investment companies, ERISA plans, and state and local government pension funds, many of whom invest in commodity futures, options, and swaps as part of their respective investment strategies.

[2] *Aggregation of Positions*, 78 Fed. Reg. 68,946 (Nov. 15, 2013).

[3] At the Roundtable, questions were asked of the Aggregation Panel as to: 1) how to reconcile the notion of basing position aggregation on control of trading rather than ownership with the relevant statutory text; and 2) how other regulations that use ownership as an indicia of control are distinguishable from position limits aggregation. We address both these questions in this letter.

[4] A copy of AMG's initial comment letter on the 2013 Aggregation NPRM, filed on February 10, 2014 ("Initial Aggregation Letter"), is enclosed for convenience.

1. Owned Entity Aggregation Should Only Apply Where There is Trading Control

1.1. Interest of Asset Managers in the Proposed Owned Entity Aggregation Rules.

Asset managers often put on commodity derivative positions directly for the funds and accounts that they manage. Asset managers also acquire equity interests in operating companies for the funds and accounts that they manage. Those operating companies also may use commodity derivatives, but the fund or account investing in the equity of the operating company, and its asset manager, typically will not have control over the commodity derivatives positions held by the operating company. While asset management companies would not generally need to aggregate customer positions managed by independent account controllers under the independent account controller ("IAC") exemption, it alone is not sufficient to assuage the concerns of AMG members with respect to the 2013 Aggregation NPRM, particularly with regard to its owned entity provisions. Individual asset managers may find it difficult to avail themselves of the IAC exemption for commodity derivatives positions held by owned entities where a fund or account that it manages has beneficial equity ownership of 10% or more. Accordingly, the owned entity aggregation requirement (and its exemptions) are vitally important to AMG members.

AMG firmly believes that aggregation should not be mandated where an asset manager, or the fund or account that it manages, is a passive investor and does not have trading control over the commodity derivatives positions of the underlying operating company in which the fund or account invests. During the Roundtable, several panelists echoed that point.

1.2. Aggregation Based on Ownership Rather than Control Is Not Required or Authorized by the CEA.

The owned entity aggregation requirement in the 2013 Aggregation NPRM is based on the view that the language of Section 4a of the CEA "requires aggregation on the basis of *either ownership or control of an entity*."[5] More specifically, the 2013 Aggregation NPRM reads the "ownership clause" of CEA Section 4a(a)(1) to permit ownership of another entity, standing alone, to serve as a separate and distinct basis to require aggregation of positions held by that owned entity, regardless of actual control of such trading accounts.[6]

As discussed in AMG's Initial Aggregation Letter, however, a close reading of the statutory text reveals that aggregation must be based on control (and not ownership alone).[7]

[5] 78 Fed. Reg. at 68,956 (emphasis added).

[6] *Id., citing* 77 Fed. Reg. at 31,773.

[7] We note that the revised staff questions posted on the Commission's website in connection with the Roundtable stated that "Section 4a(a)(1) of the CEA requires aggregation of an entity's positions on the basis of either ownership or control of the entity . . .". *See Position Limits Roundtable: Revised Staff Questions* at 6 n.9, available at http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/staffquestions061214.pdf. For the reasons discussed in text, we believe that this statement is not consistent with the correct reading of the statutory text.

Consequently, we believe that the proposed owned entity aggregation requirement of the 2013 Aggregation NPRM would exceed the Commission's authority under the CEA.[8]

The relevant portion of CEA Section 4a(a)(1) reads as follows:

> [T]he positions held and trading done by *any persons directly or indirectly controlled by such person* shall be included with the positions held and trading done by such person. . .[9]

In the first clause quoted above, the phrase "any persons" refers to third parties, whereas the phrase "such person" refers to the "investor" subject to this statutory aggregation provision. In other words, the positions held and trading done by a third party (*i.e.*, the controlled entity) which are directly or indirectly controlled by the investor shall be included with the positions held and trading done by the investor. The second clause quoted above, which is the "ownership clause" relied on by the 2013 Aggregation NPRM and which reads "positions held and trading done by such person" (*e.g.*, the investor), actually applies to positions "held" (*i.e.*, owned) and trading done (*i.e.*, performed) by the investor (and not to positions held by the controlled entity).

On its face, CEA Section 4a(a)(1), requires aggregation of positions held and trading done by third parties only when the third party's positions and trading are "*directly or indirectly controlled*." The statute specifically addresses the conditions under which a third party's positions are to be aggregated. CEA Section 4a(a)(1) does not provide for aggregation when the positions are held by a third party that is owned, but not controlled, or leave open room for inferring an "ownership aggregation" requirement by the Commission.[10]

In sum, the Commission should eliminate the owned entity aggregation requirement from any final rule as it is not authorized by the statute. By doing so, the Commission would: 1) properly limit aggregation of an owned entity's positions to the situation provided for in CEA Section 4a(a)(1), namely, where there is control of those positions; and 2) properly limit the ownership clause of CEA Section 4a(a)(1) to positions owned by the investor, not an owned entity.

1.3 Positions Held by an Owned Operating Company are Distinguishable from Positions Held in an Owned Trading Account.

Aggregation of positions held by an operating company in which an entity invests should not be required where that entity does not have actual trading control over the commodity derivatives positions held or trading done by such operating company. For example, in the asset

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[8] *See* AMG Initial Aggregation Letter at 7-8.

[9] 7 U.S.C. 6a(a)(1) (emphasis added).

[10] The legislative history of the CEA is consistent with this point. A 1968 Senate Report provides that "Section 2 of the bill amends section 4a(1) of the [CEA] to show clearly the authority to impose limits on […] trading done and positions held by a person controlled by another shall be considered as done or held by" a person (e.g., the investor). S. Rep No. 947, 90th Cong., 2 Sess. 5 (1968).

management context, commodity derivatives positions held and controlled by an operating company in which an investment fund or institutional account invests should not be aggregated with the positions controlled by the fund or account or its asset manager.

The Commission historically has interpreted "accounts" for aggregation purposes to encompass accounts owned by third parties that are commonly owned, but not commonly controlled.[11] All of the Commission's pre-2011 position aggregation rulemakings required aggregation on the basis of direct ownership in accounts, not ownership interests in third parties that, in turn, own positions in derivatives trading accounts.[12]

We believe that it is worth reiterating the practical difficulties that would be imposed on asset managers if they were required to aggregate positions held by operating companies in which the funds or accounts that they manage invest. Asset managers would need to monitor the equity ownership held by the funds and accounts that they manage for this purpose, and would need to develop some system of monitoring commodity derivatives positions held by these operating companies. Moreover, operating companies may not be willing to divulge their commodity derivatives positions to asset managers of funds or accounts that invest in these entities, and even if they would be willing, the information may not be made available on a timely basis. These challenges alone render aggregation on the basis of equity ownership in operating companies an unworkable policy.

1.4. Unlike Other, Unrelated Regulations, Ownership is Not an Appropriate Indicia of Control for Purposes of Aggregation of Commodity Derivatives Positions.

The appropriateness of basing an agency rule on an ownership threshold depends on the purpose of the particular rule at issue.[13] With respect to certain rules, including antitrust, securities, and Federal Energy and Regulatory Commission ("FERC") rules, equity ownership is relevant to rules that relate to corporate control. Conversely, equity ownership is not an appropriate indicia of control for purposes of requiring aggregation of commodity derivatives positions for speculative position limits; rules adopted in the context of corporate control are of

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[11] *See, e.g.,* the Commission's 1979 Statement of Aggregation Policy, which is squarely focused on ownership of accounts, not ownership in entities that own accounts. Its first point stated that "[e]xcept for a limited partner or shareholder (other than a commodity pool operator) in a commodity pool, any person who has a 10 percent or more financial interest in an account will be considered as an account owner." Statement of Policy on Aggregation of Accounts and Adoption of Related Reporting Rules, 44 Fed. Reg. 33,839 (Jun. 13, 1979).

[12] AMG's Initial Aggregation Letter detailed how the owned entity aggregation requirement in the 2013 Aggregation NPRM also is inconsistent with: 1) the legislative history of CEA Section 4a; 2) the Commission's historical approach to aggregation for position limit purposes; 3) other Commission rules; and 4) even the Commission's enforcement history. *See* AMG Initial Aggregation Letter at 8-11.

[13] The Commission and the Securities and Exchange Commission ("SEC") made this point in their joint "Entity Definitions Rulemaking." *See Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant,"* 77 Fed. Reg. 30,596 (May 23, 2012).

limited relevance for this purpose. As discussed above, the statutory text of CEA Section 4a(a)(1) is consistent with this view as it authorizes aggregation only where an investor *controls the trading* that occurs in an owned entity's accounts.[14]

By contrast, for example, the antitrust provisions cited in the 2013 Aggregation NPRM address when companies must file a pre-merger notification with federal regulators under the Hart–Scott–Rodino Antitrust Improvements Act. This requirement seems logical given that equity ownership is indicative of control with respect to acquisitions and size of the market. The SEC uses ownership percentages for various purposes, including requiring disclosures of information, reporting and determining the existence of restricted or control securities, but not for limiting speculative trading activity with respect to derivatives or securities within its jurisdiction. FERC's rules regulating public utility holding companies and electric power market participants address size of the market and not the type of concerns about controlling trading activity at issue in the CFTC's aggregation rulemaking.

The purpose of the Commission's aggregation rules is to help prevent coordinated trading that could yield the type of excessive speculation or manipulative activity that position limits are designed to address. Passive investors of the type managed by AMG members – even where their ownership interest exceeds 50% – simply do not have control over the commodity derivatives trading decisions of owned operating companies that would raise the specter of coordinated trading activity.[15] Conflating equity ownership with trading control in these circumstances would be misguided.[16]

2. Recap of Other Key Points from AMG's Initial Comment Letter

In addition to our views on owned entity aggregation expressed above, we would like to reiterate the following fundamental points that were expressed in further detail in our Initial Aggregation Letter and at the Roundtable:

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[14] *See also* AMG's Initial Aggregation Letter at 11-12 (detailing how the Commission traditionally has interpreted "control" in CEA Section 4a(a)(1) and its predecessors as control of trading, not corporate control).

[15] Under some circumstances, when a passive investor (for example, an ERISA plan) makes an investment in an entity, the investor's fiduciary duties (for example, as created under ERISA) could entail making prudent inquiries into the trading activities and investments of the owned entity. *See Harley v. Minnesota, Mining and Manufacturing Co*., 898 F. Supp. 2d 898, 906 (D. Minn. 1999) ('[A] fiduciary is required to undertake an independent investigation into the merits of an investment and to use appropriate, prudent methods in conducting the investigation."), *aff'd*, 284 F.3d 901 (8th Cir. 2002), *cert. denied*, 537 U.S. 1106 (2003); 29 CFR 2550.404a-1(b)(2) (providing that an investment fiduciary, when evaluating an investment, must take into consideration the risk of loss associated with the investment). This fiduciary duty to prudently inquire falls far short of coordinated trading activity.

[16] During the Aggregation Panel at the Roundtable, representatives of both CME Group and ICE explained that they use ownership as an indicia of control in performing their market surveillance function. This may be appropriate. But the use of ownership by market surveillance staff of an exchange (or the Commission) to identify situations warranting closer review, in order to determine whether coordinated trading in fact may be taking place, is far different than *requiring* aggregation of positions of owned entities, based solely on ownership of that entity, in determining whether a trader has exceeded speculative position limits.

- ***Aggregation of Investments in Accounts or Pools with "Substantially Identical Trading Strategies" Should Not be Required, Particularly where there is an Independent Account Controller***. The Commission should not adopt the requirement in proposed rule 150.4(a)(2) to aggregate investments in funds that follow "substantially identical trading strategies" regardless of common trading control, significant ownership, or even knowledge of the relevant investments. This is particularly the case in situations where the accounts or pools with "substantially identical trading strategies" have independent account controllers; where independent entities control the trading for these strategies, these positions should not be aggregated. Any contrary result would have a disparate, unjustified effect on fund-of-fund managers that invest in multiple funds employing the same or similar commodity strategy, even if the positions in those funds are controlled by independent fund managers. Further, this could run counter to other regulatory requirements, such as those applicable to investment companies registered with the SEC.[17] (See AMG's Initial Aggregation Letter at pps. 13-14.)

- ***The Independent Account Controller Exemption Should Not be Limited by CPO/CTA Registration Status*.** The Commission should extend "independent account controller" eligibility to registered commodity pool operators ("CPOs"), exempt and excluded CPOs, and exempt and excluded commodity trading advisors ("CTAs"). In addition, the burdensome requirement on asset managers to submit notice filings to claim the independent account controller exemption should be eliminated. (See AMG's Initial Aggregation Letter at p. 15.)

- ***Any Procedures Adopted to Perfect Exemptions Should be Simplified***. While we strongly believe that the Commission should forgo an owned entity aggregation requirement in any final rulemaking, if the Commission proceeds with such a requirement, we believe that the exemptions proposed in the 2013 Aggregation NPRM should be substantially liberalized. Specifically, we believe that any proposed requirements that investors ensure that the entities in which they invest maintain written procedures, that financials are not consolidated, or that directors make certifications should be eliminated. Similarly, we recommend eliminating any notice filing requirements for the owned entity exemption, or at the very least, allowing use of a simplified, generic omnibus filing.[18] (See AMG's Initial Aggregation Letter at pps. 4-7, 15).

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[17] *See, e.g.,* Section 12(d)(A)(1) of the Investment Company Act of 1940 and the rules promulgated thereunder, which impose limits on the amount of investments that a registered investment fund may make in any other registered investment company; this requirement could cause a registered fund-of-funds to invest in multiple funds with substantially identical trading strategies.

[18] This recommendation with respect to filing requirements applies to both an owned entity aggregation exemption, to the extent owned entity aggregation remains part of any final rule, and the independent account controller exemption.

- ***Passive Investors in Rule 4.13 Exempt Pool Aggregation Requirement.*** The Commission should revise proposed rule 150.4(b)(1)(iii) to require passive investors to aggregate positions of a Rule 4.13 exempt pool based on a 25% or more ownership interest only when "the operator of which is exempt from registration *under §§ 4.13(a)(1) or (a)(2).*" This revision is appropriate in order for the requirement to apply to its intended targets. (See AMG's Initial Aggregation Letter at p. 13.)

3. Summary

For the reasons stated above, AMG recommends that the Commission not adopt the proposed owned entity aggregation rules as proposed in the 2013 Aggregation NPRM. Instead, the rules should be revised as discussed above in order to address their impact on passive investors that have no control over, or even knowledge of, the specific commodity derivatives trading activities of owned entities in which they have invested.

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We appreciate your consideration of our comments. We stand ready to provide any additional information or assistance that the Commission might find useful. Should you have any questions, please do not hesitate to contact Matt Nevins at 212-313-1176 or Terry Arbit at Norton Rose Fulbright at 202-662-0223.

Sincerely,

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Enclosures: AMG Initial Comment Letter Regarding Notice of Proposed Rulemaking – Aggregation of Positions (RIN 3038-AD82)

cc (w/encl): Timothy G. Massad, Chairman
Mark P. Wetjen, Commissioner
Sharon Y. Bowen, Commissioner
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Re: ***Notice of Proposed Rulemaking – Aggregation of Positions (RIN 3038-AD82)***

The Asset Management Group ("AMG")[1] of the Securities Industry and Financial Markets Association ("SIFMA") appreciates the opportunity to provide the Commodity Futures Trading Commission (the "Commission") with comments regarding the "Aggregation of Positions" proposed rulemaking ("2013 Aggregation NPRM").[2] We believe that the Commission has made some positive steps in this 2013 Aggregation NPRM, but we have some significant concerns with respect to certain aspects of the proposal, in the following areas in particular:

- ***Owned Entity Aggregation.*** The Commission should not adopt the owned entity aggregation as proposed. Requiring passive investors, which include, without limitation, registered and private commodity pools and other investment vehicles, pension funds and other institutional clients of asset managers, that have no control over, or even knowledge of, the specific commodity derivatives trading activities of owned entities they have invested in to aggregate the positions of such entities would impose significant costs that would unnecessarily diminish their ability to provide valuable capital investment and generate returns for their beneficiaries and participants, exceeds the scope of the Commission's position aggregation authority under the Commodity Exchange Act ("CEA"), and is an unwarranted departure from the Commission's historical aggregation approach. The proposed exemptions from this owned entity aggregation requirement under proposed rules 150.4(b)(2) (10 to 50% ownership) and (b)(3) (above 50% ownership) do not sufficiently address the flaws of the proposed approach to aggregating owned entity positions in the passive investment ownership context.

[1] The AMG's members represent U.S. asset management firms whose combined assets under management exceed $20 trillion. The clients of AMG member firms include, among others, registered investment companies, ERISA plans, and state and local government pension funds, many of whom invest in commodity futures, options, and swaps as part of their respective investment strategies.

[2] 78 Fed. Reg. 68,946 (Nov. 15, 2013).

- ***Investment in Accounts or Pools with "Substantially Identical Trading Strategies."*** The Commission should not adopt the aggregation requirement in proposed 150.4(a)(2) for investments in funds that follow "substantially identical trading strategies" regardless of common trading control, significant ownership, or even knowledge of the relevant investments. This proposal is vague and lacks sufficient statutory, policy, and cost-benefit rationale.

- ***Passive Investors in Commission Regulation 4.13 Exempt Pool Aggregation Requirement.*** We recommend that the Commission amend 150.4(b)(1)(iii) to only require passive investors to aggregate positions of a Commission regulation 4.13 exempt pool based on a 25% or more ownership interest when "the operator of which is exempt from registration *under §§ 4.13(a)(1) or (a)(2)*" in order for this requirement to apply to its intended targets.

- ***Independent Account Controller Exemption.*** We recommend that the Commission extend "independent account controller" eligibility to registered commodity pool operators ("CPOs"), exempt CPOs, and exempt and excluded commodity trading advisors ("CTAs"). We also question the utility of the burdensome requirement on asset managers to submit notice filings to claim the independent account controller exemption.

1. Owned Entity Aggregation

Consistent with current 17 CFR 150.4(a), under proposed 150.4(a)(1), a person would be required to aggregate "positions in accounts" in which the person "directly or indirectly" has more than a 10% ownership interest. The Commission further proposes to interpret "accounts or positions" to include "accounts or positions" of third party[3] owned entities.[4] The Commission interprets ownership of another entity, standing alone, as providing a separate and distinct basis to require aggregation of the positions owned by the owned entity, regardless of actual control of such trading accounts.[5] That is, the Commission interprets the "ownership prong" of CEA section 4a(a)(1) to apply to accounts owned by owned entities if a person has an ownership interest greater than 10% in that owned entity (and otherwise does not have trading control or have a direct ownership interest in the owned entity accounts themselves).[6]

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[3] We use the term "third party" to refer to any person that is separate from another person. A person can have relationships with many types of third parties, e.g., an owned entity, an entity it does not have an ownership interest in but whose trading it controls, etc.

[4] *See* proposed 150.4(b)(2) (providing for an exemption from aggregation requirements for positions in accounts of an owned entity when the ownership interest in the owned entity is between 10 and 50% of total equity). *See also* 78 Fed. Reg. at 68,959.

[5] *Id.* citing 77 Fed. Reg. at 31,773.

[6] *Id.* ("The Commission continues to believe, as stated in the Part 151 Aggregation Proposal, that an equity or ownership interest above 50% constitutes a majority ownership or equity interest of the owned entity and is so significant as to justify aggregation under the ownership prong of Section 4a(a)(1) of the CEA.")

For the reasons set forth below, we recommend that the Commission reconsider its proposed owned entity aggregation rules. We present our specific recommendations in section 1.3 below.

1.1. Requiring passive investors that have no control over, or even knowledge of, the specific commodity derivatives trading activities of owned entities to aggregate the positions of such entities will be unduly costly.

While asset management companies would not generally need to aggregate customer positions managed by independent account controllers under proposed 150.4(b)(5)'s independent account controller ("IAC") exemption, individual IAC or non-IAC asset managers often invest customer assets (either directly or through investment vehicles) in entities that trade in commodity derivatives. Under the Commission's proposed 150.4(a), 10% or more ownership in a trading account may be sufficient to warrant aggregation. In this case, under the Commission's interpretation of the term "account,"[7] a purely passive holder of equity securities would be required to aggregate the positions of all entities of which it has beneficial equity ownership of 10% or more, unless it perfects an exemption to owned entity aggregation (most pertinently under proposed 150.4(b)(2) or (b)(3)). An arbitrary owned entity aggregation threshold at 10% ownership is vastly over-inclusive even if it is used as indicia of corporate control;[8] the Commission itself points out that corporate "control" is imputed at 50% or more ownership for the purpose of pre-merger notifications to federal regulators under the Hart–Scott–Rodino Antitrust Improvements Act.[9]

Passive investors of the type managed by AMG members do not have control over owned entities by virtue of their *passive* ownership interest in a legal entity. As such, they would typically only have minimal knowledge of these owned entities' trading positions and decisions.[10] The 2013 Aggregation NPRM would create a new standard of care for passive investors: they would have to determine whether and to what extent the owned entity (and all of its owned entity affiliates) trade in commodity derivatives and if so, act to perfect an exemption. If no exemption is available, then the passive investor would have to obtain reliable commodity

[7] We believe this reading would constitute an unexplained change from Commission administrative precedent. *See* section 1.4 below.

[8] As discussed below in section 1.7, the appropriate control standard under Commission position limits rules relates to trading control, not corporate control.

[9] 78 Fed. Reg. at 68,958, *citing* 16 CFR 801.1(b).

[10] Under some circumstances, when a passive investor (for example an Employee Retirement Income Security Act ("ERISA") plan) makes an investment in an entity, the investor's fiduciary duties (for example, as created under ERISA) could very well entail making prudent inquiries into the trading activities and investments of the owned entity. *See Harley v. Minnesota, Mining and Manufacturing Co*., 898 F. Supp. 2d 898, 906 (D. Minn. 1999) ('[A] fiduciary is required to undertake an independent investigation into the merits of an investment and to use appropriate, prudent methods in conducting the investigation."), *aff'd,* 284 F.3d 901 (8th Cir. 2002), *cert. denied*, 537 U.S. 1106 (2003); 29 CFR § 2550.404a-1(b)(2) (providing that an investment fiduciary, when evaluating an investment, must take into consideration the risk of loss associated with the investment).

derivatives position information from the entities in which it invests and is required to aggregate in order to ensure compliance with speculative position limits. In addition, these passive investors would have to develop, often from scratch, costly position monitoring infrastructure and hire or train staff to apply that infrastructure to the derivatives positions of their investments in order to ensure compliance with position limits. These costs to passive investors would deter investment in businesses that own commodity positions and are not offset by any commensurate benefit, especially in terms of reduced likelihood of excessive speculation or manipulation.

1.2. The proposed owned entity aggregation exemptions provide inadequate relief for passive investors and do nothing to further the goals Congress directed the Commission to achieve in promulgating position limits.

The Commission proposes two exemptions to the proposed general rule that requires a person to aggregate accounts owned by a third-party entity where such person has a greater than 10% ownership in the owned entity:

1. Under proposed 150.4(b)(2), the Commission proposes an aggregation exemption for ownership interests of up to 50% of an entity's equity under certain conditions. The owner and the owned entity ("Related Entities") must not have knowledge of one another's trading decisions and have in place protections to ensure independence, including: (1) enforced written procedures to prevent sharing of trading information; (2) physical separations; (3) separately developed and independent trading systems; (4) no sharing of employees that control trading decisions; and (5) no sharing of risk management systems that permit sharing of trading information or strategies before a trade is made. This exemption is effective upon submission of a notice filing under proposed 150.4(c)(1).

2. Under proposed 150.4(b)(3), the Commission proposes an aggregation exemption for ownership interests above 50% ownership under certain conditions. These conditions include all of those described above for ownership interests at and below 50% ownership, plus: (1) certification that the Related Entities' financial results are not consolidated in a financial statement pursuant to relevant accounting rules; (2) each director for the owned entity certifies that (a) all of the owned entity's positions are bona fide hedging positions, or (b) the owned entity's positions do not exceed 20% of any position limit. This exemption must be approved by the Commission or staff operating under delegated authority in order to become effective under proposed 150.4(c)(2).

These two exemptions would provide inadequate relief for passive investors and would do nothing to further the goals Congress directed the Commission to achieve in promulgating position limits.

First, while a move in the right direction, the proposed 150.4(b)(2) exemption from aggregation for ownership interests of up to 50% in the owned entity does not extend to all ownership interests and would require a burdensome notice filing in all investment circumstances, regardless of the absence of common trading control, for no apparent benefit. By

contrast, passive investors in a pool that are not affiliated with the pool operator under proposed 150.4(b)(1) would not be required to submit a notice filing to disaggregate the positions of pools in which they have invested, regardless of their ownership interest in the pool. Again, the 2013 Aggregation NPRM provides no reason why passive investors in owned entities should not have at least the same degree of deference.

Second, the proposed application-based exemption from aggregation in 150.4(b)(3) for ownership interests in excess of 50% is, as a practical matter, unworkable. Passive investors cannot plan their investment and compliance programs around a disaggregation application filing that depends on Commission approval which, even if granted, may take weeks or months to issue, while their managers may need to make immediate investment decisions.

Moreover, the conditions imposed on the proposed 150.4(b)(3) exemption seriously constrain its utility. This is particularly true of the condition prohibiting consolidation of financial results. The fact that an investor consolidates the financial results of the firms in which it invests is not indicative of trading control; earning returns on an investment is the main reason an investor invests. In addition, the requirement that the owned entity's positions not exceed 20% of any position limit effectively subjects owned entities to lower position limits.[11] The 2013 Aggregation NPRM makes no findings that this restriction furthers any of the goals Congress directed the Commission to achieve in promulgating position limits rules under CEA sections 4a(a)(2)(C) and 4a(a)(3)(B).

1.3. The Commission should reconsider its owned entity aggregation requirements.

For reasons stated in more detail in section 1.4 below, we believe the Commission's proposed owned entity aggregation requirements are legally flawed and based on an erroneous interpretation of the CEA and applicable administrative precedent. We recommend, therefore, that the Commission re-examine the 2013 Aggregation NPRM and substantially amend the proposed 150.4(b)(2) and (3) exemptions to achieve a more appropriate balance among the six statutory factors that the CEA requires the Commission to address when promulgating any position limit rules,[12] by:

[11] The alternative requirement that all of the owned entity's positions be bona fide hedging positions is not an independent condition. CEA section 4a(c)(1) prohibits the Commission from restricting the bona fide hedging positions of any trader: "No rule, regulation, or order issued under subsection (a) of this section shall apply to transactions or positions which are shown to be bona fide hedging transactions[.]" CEA section 4a(c)(1). Therefore, the limitation that an owned entity's positions be limited entirely to bona fide hedging positions is simply a sub-set of the requirement that would restrict speculative positions up to 20% of any limit.

[12] These factors include the "goals" stated in CEA section 4a(a)(2)(C), i.e., "striv[ing] to ensure" that (Factor 1) "trading on foreign boards of trade in the same commodity will be subject to comparable limits" and (Factor 2) "that any limits to be imposed by the Commission will not cause price discovery in the commodity to shift to trading [to FBOTs]." They also include the four additional factors that CEA section 4a(a)(3)(B) directs the Commission to balance when exercising its CEA section 4a(a)(2) authority: (1) (Factor 3) to diminish, eliminate, or prevent excessive speculation causing sudden or unreasonable fluctuations or unwarranted changes in price; (2) (Factor 4) to deter and prevent market manipulation, squeezes, and corners; (3) (Factor 5) to ensure sufficient market liquidity for bona fide hedgers; and (4) (Factor 6) to ensure that the price discovery function of the underlying market is not disrupted.

1. Extending the relief provided to passive investors in commodity pools under current 150.4(c) and proposed 150.4(b)(1) to passive investors in owned entities that do not have actual trading control of the owned entity's derivatives trading; and

2. Extending the owned entity exemption at proposed 150.4(b)(2) to include all third party ownership interests (greater than 50%) that do not involve actual common trading control.

In addition, we recommend three additional, non-exclusive changes that would reduce the cost to comply without forgoing meaningful regulatory benefit under the six statutory factors referenced above:

Filing requirements: The Commission should only require a 150.4(c)(1) notice filing when there is majority ownership in addition to indicia of trading control, e.g., a common business purpose relating to derivatives trading or the commercial use of commodities. The Commission's proposed 150.4(c)(2) application procedure should be omitted altogether or reserved for instances where there is majority ownership in addition to a trading control. In any event, a passive investor that holds an equity investment of any amount in an operating company that it has no trading control over should not be required to make any type of filing. If the Commission insists on a filing requirement for passive investors, then it should allow for a simplified, generic omnibus filing that would provide the Commission with notice that a passive investor intends to use the exemption on a going-forward basis consistent with the terms of the exemption for its passive equity investments.

Pro rata attribution of positions: The Commission should allow for the *pro rata* attribution of positions based on ownership interest. *Pro rata* allocation of positions would be less costly for passive investors because it would provide them some proportionate degree of protection if their owned entity exceeds a position limit. For example, for a passive investor with a 15% ownership interest in an owned entity that exceeds a position limit, an allocation of 15% or even 25% of that owned entity's positions would reduce the risk of an inadvertent position limits overage. Accordingly, we recommend *pro rata* allocation of ownership interests within set bands of ownership percentages.

Quarterly measurement: The costs of complying with the Commission's proposed aggregation rules would also be reduced if the Commission provided a safe harbor to passive investors to measure ownership interests on a predetermined basis, such as on quarterly dates. Permitting passive investors to measure ownership interests on a fixed and workable schedule will not undermine the Commission's position limits regime. This approach would mitigate our members' concerns about disruptions to their clients' investments that could otherwise result from frequent changes in ownership interests.

These recommendations would present substantially reduced costs for AMG members and their clients yet would still ensure at least the same degree of efficacy of the Commission's position limits regime under the goals provided by Congress in CEA sections 4a(a)(2)(C) and 4a(a)(3)(B) by providing passive investors with legal certainty that would promote liquidity in

commodity derivatives. In fact, the Commission's proposal would increase the potential for coordinated manipulative trading activity because it mandates common trading control where none currently exists.

1.4. Requiring passive investors that have no control over, or knowledge of, the specific commodity derivatives trading activities of owned entities they have invested in to aggregate the positions of such entities has not been justified.

1.4.1. Requiring passive investors that have no control over, or knowledge of, the specific commodity derivatives trading activities of owned entities they have invested in to aggregate the positions of such entities exceeds the scope of the Commission's position aggregation authority under the CEA.

The 2013 Aggregation NPRM states its basis for requiring the aggregation of owned entity positions regardless of the existence of common trading control as follows (emphasis added):

> In light of the language in section 4a, its legislative history, subsequent regulatory developments, and the Commission's historical practices in this regard, the Commission continues to believe that section 4a requires aggregation on the basis of *either ownership or control of an entity*.[13]

The relevant portion of CEA section 4a(a)(1) provides (emphasis added):

> [T]he positions held and trading done by *any persons directly or indirectly controlled by such person* shall be included with the positions held and trading done by such person; and further, such limits upon positions and trading shall apply to positions held by, and trading done by, two or more persons acting pursuant to an expressed or implied agreement or understanding, the same as if the positions were held by, or the trading were done by, a single person.

CEA section 4a(a)(1), by its terms, requires aggregation of positions held and trading done by third parties only when the other person is "*directly or indirectly controlled*."[14] This is not a situation where the CEA is silent about aggregating the positions of third parties (including owned entities) so that the Commission might fill the gap by inferring that the "ownership prong" applies to positions held by an owned third party; rather, the statute specifically addresses the conditions under which a third party's positions are to be aggregated, i.e., when the positions

[13] 78 Fed. Reg. at 68,956.

[14] In the first critical clause quoted above, the phrase "any person" refers to a third party, whereas the phrase "such person" refers to the principal person subject to this statutory aggregation provision. Thus, re-phrasing the clause slightly for purposes of clarification, the positions held and trading done by a third party (e.g., the company in which an investor invests) directly or indirectly controlled by a person (e.g., the investor) shall be included with the positions held and trading done by that person (e.g., the investor). By contrast, the "ownership prong" that appears immediately after this first clause applies only to directly held positions ("positions held and trading done by such person," e.g., the investor).

held and trading done by the third party are "directly or indirectly controlled." With respect to positions held and trading done by third parties, CEA section 4a(a)(1) imposes a constraint on the Commission's authority to require aggregation. CEA section 4a(a)(1) provides that the aggregation of positions held and trading done by third parties is to occur only when the positions held and trading done by the third party are "directly or indirectly controlled" ("Third Party Aggregation Constraint").

The statutory Third Party Aggregation Constraint is consistent with the legislative history of CEA section 4a. As cited in the Commission's 2012 "Aggregation, Position Limits for Futures and Swaps" proposed rulemaking,[15] a 1968 Senate Report provides that "Section 2 of the bill amends section 4a(1) of the [CEA] to show clearly the authority to impose limits on […] trading done and positions held by *a person controlled by another* shall be considered as done or held by" a person (e.g., the investor).[16]

1.4.2. Requiring passive investors that have no control over, or knowledge of, the specific commodity derivatives trading activities of owned entities they have invested in to aggregate the positions of such entities is an unwarranted departure from the Commission's historical aggregation approach.

The Commission interprets 17 CFR 150.4(b) and proposed Commission regulation 150.4(a) as requiring the aggregation of owned entity positions.[17] The Commission, however, has never promulgated rules (that were not vacated) in which it has interpreted "accounts" to encompass accounts owned by third parties that are commonly owned but not commonly controlled. All of the Commission's pre-2011 position aggregation rulemakings required aggregation on the basis of direct ownership in accounts, not ownership interests in third parties who, in turn, own positions in derivatives trading accounts.

For example, the Commission's 1979 Statement of Aggregation Policy is squarely focused on ownership of accounts, not ownership in entities that own accounts.[18] Its first point stated that "[e]xcept for a limited partner or shareholder in a commodity pool, any person who has a 10% or more financial interest *in an account* will be considered as an account controller" (emphasis added).[19] The 1979 Statement of Aggregation Policy defines "discretionary account" as "a commodity futures trading account for which buying and/or selling orders can be placed or originated, or for which transactions can be effected…"[20]

[15] 77 Fed. Reg. 31,767 (May 30, 2012).

[16] *Id.* at 31,772 at fn. 80, citing S. Rep No. 947, 90th Cong., 2 Sess. 5 (1968) (emphasis added).

[17] Proposed 150.4(a) ("For the purpose of applying the position limits set forth in § 150.2, unless an exemption set forth in paragraph (b) of this section applies, all positions in accounts for which any person, by power of attorney or otherwise, directly or indirectly controls trading or holds a 10% or greater ownership or equity interest, must be aggregated with the positions held and trading done by such person.").

[18] Statement of Policy on Aggregation of Accounts and Adoption of Related Reporting Rules, 44 Fed. Reg. 33,839 (Jun. 13, 1979).

[19] *Id.* at 33,845.

[20] *Id.*

The 2013 Aggregation NPRM presents the following quote from a position limits rulemaking from 1999 in an attempt to support its interpretation that CEA section 4a(a)(1)'s "ownership prong" includes ownership of third parties' accounts: "the Commission . . . interprets the 'held or controlled' criteria [of CEA section 4a] as applying separately to ownership of positions or to control of trading decisions."[21] However, this quote does not refer to accounts of owned entities. This is not surprising as, again, this 1999 rulemaking was squarely focused on the aggregation of directly owned accounts – and not of accounts owned by an owned third party. For example, the 1999 rulemaking provided that when a person "holds or has a financial interest in or controls more than one account, all such accounts shall be considered by the futures commission merchant, clearing member or foreign broker as a single account…"[22] Thus, neither the quote nor the rulemaking from 1999 support the interpretation in the 2013 Aggregation NPRM.

Contrary to the assertion of the 2013 Aggregation NPRM, the Commission has in fact clearly distinguished between ownership of accounts, on the one hand, and ownership in third party entities that themselves own accounts, on the other. In the context of its CFTC Form 40 rules at 17 CFR 18.04(a)(8), the Commission requires the reporting of information relating to "persons… who have a financial interest of 10% or more in the [Form 40] reporting trader *or* the accounts of the reporting trader" (emphasis added). If financial interests in "accounts" encompassed financial interests in accounts of other persons, then the Commission would have had no need to separately articulate the requirement to report financial interests in the accounts of a reporting trader and the requirement to report financial interests in the reporting trader itself.

The Commission's historical definition of "account" in the position aggregation context is consistent with other Commission regulations that also similarly define the term "account." For example, 17 CFR 39.2 defines "customer account" as meaning "a clearing member account held on behalf of customers, as that term is defined in this section, and which is subject to section 4d(a) or section 4d(f) of the [CEA]" and "house account" as meaning "a clearing member account which is not subject to section 4d(a) or 4d(f) of the [CEA]." 17 CFR 1.3(vv) defines "futures account" to mean an "account that is maintained in accordance with the segregation requirements of sections 4d(a) and 4d(b) of the [CEA] and the rules thereunder." None of these regulations define an "account" as encompassing accounts of owned entities.

The one exception is the Commission's definition of "proprietary account" in 17 CFR 1.3(y),[23] which is defined explicitly to include accounts held by "business affiliates."[24] This term

[21] 78 Fed. Reg. at 68,956, *quoting* Revision of Federal Speculative Position Limits and Associated Rules, 64 Fed. Reg. 24,038, 24,044 (May 5, 1999).

[22] *Id.* at 24,046.

[23] 17 CFR 1.3(y) "*Proprietary account*. This term means a commodity futures, commodity option, or swap trading account carried on the books and records of an individual, a partnership, corporation or other type of association: (1) for one of the following persons, or (2) of which ten percent or more is owned by one of the following persons, or an aggregate of ten percent or more of which is owned by more than one of the following persons:

[...]

is cited as support for the Commission's new interpretation of the term "account" in the position limits context.[25] The term "proprietary account," however, is irrelevant to the position limits context. The term "proprietary account" is used in 17 CFR 155.3, which requires that a futures commission merchant ("FCM") give priority to executing customer orders over orders from any "proprietary account." Moreover, the fact that the term "proprietary account" is explicitly defined to include accounts held by "business affiliates" suggests that in the Commission's regulations, the term "account," standing alone, does not include accounts of owned entities but rather refers only to directly held or controlled trading accounts.

Even the Commission's enforcement history reflects that it has traditionally viewed aggregation of owned entity positions as only being required where there is common derivatives trading control. The import of the Commission's Order settling an administrative enforcement action in September 2010 against Vitol Inc. and one of its affiliates for false statements in connection with NYMEX position aggregation rules (which parallel Commission rules),[26] is that control was a pre-requisite in considering whether Vitol Inc. was required to aggregate the positions of its commonly-owned affiliate.[27] The recitation of facts in the Commission's Order

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> (viii) A business affiliate that, directly or indirectly is controlled by or is under common control with, such individual, partnership, corporation or association: P*rovided, however*, That an account owned by any shareholder or member of a cooperative association of producers, within the meaning of section 6a of the [CEA], which association is registered as a futures commission merchant and carries such account on its records, shall be deemed to be an account of a customer and not a proprietary account of such association, unless the shareholder or member is an officer, director or manager of the association."

[24] 17 CFR 1.3(y)(1)(viii).

[25] 78 Fed. Reg. 68,956 citing 17 CFR 1.3(y).

[26] "Ownership of Accounts – Except as set forth in Section E. below, any person holding positions in more than one account, or holding accounts or positions in which the person by power of attorney or otherwise directly or indirectly has a 10% or greater ownership or equity interest, must aggregate all such accounts or positions unless such person is a limited partner, shareholder, member of a limited liability company, beneficiary of a trust or similar type of pool participant in a commodity pool. […]." CME Rule 559.D.2, available at http://www.cmegroup.com/rulebook/CME/I/5/5.pdf. Certain commodities are currently subject only to position limit rules set by designated contract markets ("DCMs"). Aggregation for purposes of DCM-set position limits today is governed by Core Principle 5 "Position Limitations or Accountability" in CEA section 5(d)(5) and subpart F of 17 CFR part 28. CEA section 5(d)(1)(B) provides that DCMs have "reasonable discretion in establishing the manner in which the board of trade complies with the core principles described in this subsection" unless "otherwise determined by the Commission by rule or regulation." Under 17 CFR 38.301, DCMs "must meet the requirements of parts 150 and 151 of this chapter, as applicable." The only Commission regulation that relates to the aggregation of positions for exchange-set position limits (and that was not vacated) is 17 CFR 150.5(g). 17 CFR 150.5(g) provides that DCMs must aggregate on the basis of control and does not prescribe any other standard:

> In determining whether any person has exceeded the limits established under this section, all positions in accounts for which such person by power of attorney or otherwise directly or indirectly controls trading shall be included with the positions held by such person[.]

[27] In the Matter of Vitol Inc. et al., Docket No. 10-17 (CFTC Sept. 14, 2010), available at http:// www.cftc.gov/ucm/groups/public/@lrenforcementactions/documents/legalpleading/enfvitolorder09142010.pdf. In this matter, the Commission found that Vitol Inc. and its affiliate willfully failed to correct NYMEX's misperception of the "true nature of the relationship between" Vitol Inc. and its affiliate and imposed a civil monetary penalty of $6 million.

focused on Vitol Inc.'s failure to disclose information relating to the "flow of trading information between" the affiliated entities and the "limited nature of the barriers to trading information flow between" these presumably commonly owned Vitol affiliates.[28] These facts would have been relevant only if common control were a pre-condition to the application of the position aggregation rules (as it is due to the statutory Third Party Aggregation Constraint). Tellingly, no facts relating to common ownership were included in the Order.[29]

1.4.3. The 2013 Aggregation NPRM uses an inappropriate baseline in considering the costs and benefits of its proposed owned entity aggregation rules.

In its discussion of "Cost-Benefit Considerations," the 2013 Aggregation NPRM states that its proposed owned entity aggregation policy is "more permissive than the 10% [owned entity position aggregation] threshold currently provided."[30] It therefore assumes a cost-benefit baseline that requires aggregation of positions for position limit compliance purposes based solely on ownership, regardless of the existence of common control.

This is an inappropriate baseline for two important reasons. First, as described above, neither the Commission nor DCMs (which currently are the sole administrators of position limits for all but nine agricultural commodities, including 19 of the 28 "referenced contracts"), currently require the aggregation of owned entity positions regardless of the existence of common control. Therefore, the Commission's proposal is more restrictive, not "more permissive" than (and, indeed, a dramatic departure from) the existing position aggregation regime. Second, speculative positions outside of the spot month have not been subject to position limits in 19 of the 28 "referenced contract" markets the Commission proposes to subject to position limits under an accompanying release.[31] Aggregating non-spot-month positions of entities in which passive investors make investments presents considerable new challenges, which have not been adequately considered by the 2013 Aggregation NPRM.

1.4.4. "Control" in the context of position aggregation requirements means actual control of derivatives trading, not of anything else, and therefore the owned entity aggregation requirements cannot be based on a theory of corporate control.

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[28] *Id.*

[29] *See also* Order Instituting Proceedings Pursuant to Sections 6(c) and 6(d) of the Commodity Exchange Act, as Amended, Making Findings and Imposing Remedial Sanctions, at 4, http://www.cftc.gov/ucm/groups/public/@lrenforcementactions/documents/legalpleading/enfcitigroupcgmlorder092112.pdf (Sept. 21, 2012) (finding that Citigroup was liable for the position limits violation of its subsidiary Citigroup Global Markets not on the basis of owned entity aggregation requirements under 17 CFR 150.4(b), but rather on the basis of an agency theory (CEA section 2(a)(1)(B) and 17 CFR 1.2).

[30] 78 Fed. Reg. at 68,968.

[31] 78 Fed. Reg. at 75,826. AMG is commenting separately on this proposal, including proposed 150.5(a)(5) providing that aggregation requirements of exchanges must "conform to" those of the Commission under proposed 150.4.

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As noted above, the 2013 Aggregation NPRM bases its proposed owned entity aggregation rules solely on CEA section 4a(a)(1)'s "ownership prong." The 2013 Aggregation NPRM suggests in defense of the 50% ownership aggregation exemption threshold in proposed 150.4(b)(2) that an ownership interest of greater than 50% "is indicative of control" and therefore warrants aggregation of an owned entity's positions even in the absence of any actual trading control. This conclusion appears to be based on conflated notions of corporate control in other contexts with trading control in the position limits context. The Commission cites a 50% equity ownership threshold used by the Federal Trade Commission and Department of Justice as "reflect[ing] a general understanding that ownership at this level poses substantial potential for direct or indirect control over an owned entity."[32] This threshold is used by these other government agencies to identify potential instances of common corporate control for the purpose of anti-trust filing requirements, not of common derivatives trading control.[33] Speculative position limits aggregation requirements are based on whether ownership is indicative of derivatives *trading control*, not corporate control.

The Commission has traditionally interpreted "control" in CEA section 4a(a)(1) and its predecessors as control of trading, not of corporate control or any other concept of control. For example, the Commission's current IAC exemption to position aggregation requirements focuses on the controller's independent control of trading decisions and lack of knowledge of the trading decisions of any other IAC.[34] Indeed, the 2013 Aggregation NPRM appropriately models the conditions for the owned entity aggregation exemption in proposed 150.4(b)(2) on the conditions for the IAC exemption, i.e. factors that demonstrate independent trading control. Similarly, the Commission's definition of "controlled account" at 17 CFR 1.3(j) means an account for which a person "actually directs trading."[35] Perhaps most important of all, the terms of the Commission's proposal appear to focus on trading control, not corporate control. The Commission's proposed general aggregation rule (150.4) requires aggregation when a person "directly or indirectly controls *trading*."

Thus, even if the Commission were to abandon the ownership theory relied upon in the 2013 Aggregation NPRM for a control theory instead, the result is the same: the proposal provides no basis for the Commission to depart from its historical view that position aggregation is required only where actual common trading control exists, e.g., when an investor controls the derivatives trading that occurs in a an owned entity's accounts.[36]

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[32] 78 Fed. Reg. at 68,958, *citing* 16 CFR 801.1(b).

[33] *See* 16 CFR 802.2.

[34] 17 CFR 150.1(e).

[35] *See also* CFTC Form 102, available at http:// www.cftc.gov/ucm/groups/public/@forms/documents/file/cftcform102.pdf (prompting FCMs and others to identify "controlled accounts" of the same advisor exceeding "special account" activity thresholds).

[36] 78 Fed. Reg. at 68,958.

2. Passive Investment in Commission Regulation 4.13 Exempt Commodity Pools

2.1. The passive 17 CFR 4.13 exempt pool investor aggregation requirement should be omitted.

The 2013 NPRM proposes to require aggregation of positions in a 17 CFR 4.13 pool when a person holds a greater than 25% ownership interest in the pool under proposed 150.4(b)(1)(iii). This proposed rule is identical to current Commission rule 150.4(c)(2)(iii). The rationale for the current rule was that when there are "10 or fewer limited partners or when a limited partner has an ownership interest of 25% or greater, the limited partner" should be required to aggregate the positions of the pool.[37] The Commission was particularly concerned about single-investor pools when it adopted this requirement.[38] The only sub-paragraphs of current 17 CFR 4.13 that encompass the intended targets of this provision are sub-paragraphs (a)(1) and (a)(2). We therefore recommend that the Commission amend 150.4(b)(1)(iii) to apply to pools "the operator of which is exempt from registration *under §§ 4.13(a)(1) or (a)(2)*" in order for this requirement to apply to its intended targets.

3. Investment in Accounts or Pools with "Substantially Identical Trading Strategies"

Proposed 150.4(a)(2) provides that holding or controlling trading in more than one account or pool (collectively "funds") with "substantially identical trading strategies" requires aggregation ("SITS Rule"). This requirement would apply notwithstanding any other applicable aggregation exemption. In other words, the proposed SITS Rule would apply regardless of common control, significant ownership, or even knowledge of the relevant investments in funds with "substantially identical trading strategies."

The proposed SITS Rule should be omitted from any final rulemaking because it lacks sufficient rationale and is unworkable in practice, as discussed below. In the alternative, proposed 150.4(a)(2) should be amended to apply to "any person that, by power of attorney or otherwise, ~~holds or~~ directly controls the trading of positions" in a SITS account or pool.

3.1. The proposed SITS Rule lacks rationale.

The Commission does not provide a statutory or policy rationale for the proposed SITS Rule in the 2013 Aggregation NPRM or its 2012 predecessor.[39] The Commission's 2011 "Position Limits for Futures and Swaps" final rulemaking did contain a short rationale for a similar requirement for investments in funds with "identical trading strategies."[40] This provision, the Commission stated, was "intended to prevent circumvention of the aggregation requirements.

[37] 64 Fed. Reg. at 24,044.

[38] *Id.*

[39] There are, however, four mentions of the "identical trading strategies" rule in footnotes to the 2012 proposal. *See* e.g., 77 Fed. Reg. at 31,769 at fn. 14.

[40] *See* vacated 151.4(d).

In [the] absence of such [an] aggregation requirement, a trader can, for example, acquire a large long-only position in a given commodity through positions in multiple pools, without exceeding the applicable position limits."[41] However, the 2011 rulemaking provided no historical example of any such circumvention.[42]

Finally, the 2013 Aggregation NPRM fails altogether to consider the costs and benefits of the aggregation requirement for investments in funds that follow "substantially identical trading strategies," despite the very real costs that such a requirement would have on investors.

3.2. The proposed SITS Rule is unworkable in practice.

As a consequence of the proposed SITS Rule, a $10,000 investor in two $1 billion commodity index mutual funds using the same index may have to aggregate the positions in those two $1 billion mutual funds because they follow "substantially identical trading strategies." To provide another example, under the proposed SITS Rule, a $10,000 investor in a fund-of-funds that, in turn, invests $10,000 in two $1 billion commodity index funds that follow "substantially identical trading strategies" would have to aggregate the positions in those two $1 billion funds – even if the investor did not know how the fund-of-funds manager allocated the investor's money. (In contrast, under proposed 150.4(b)(1)'s exemption for investors in commodity pools, it appears that if an investor made a $500 million investment in a single $1 billion commodity index pool, it would be exempt from speculative position limits altogether).

To comply with the aggregation requirement of the proposed SITS Rule, the investor in the foregoing scenarios would not only have to determine how his or her funds are being invested, but also the trading strategies of all of the relevant funds and whether they meet the undefined test of being "substantially identical." Then, he or she would need a data feed to determine the size of the commodity derivatives positions in each fund determined to be using a "substantially identical trading strategy." Such a requirement would simply be unworkable in most cases (depending on, among other things, the size of the investment, the size of the funds with "substantially identical trading strategies" that the investor's money has been invested in, and the investor's other countable commodity derivatives positions). Even if it could be done (the practical impediments described above aside, there would also be significant and costly legal and operational obstacles to overcome), to implement such a compliance program to prevent inadvertent violations of speculative position limits due to the aggregation requirement of the proposed SITS Rule, would cost many times the investor's $10,000 investments.

[41] 76 Fed. Reg. at 71,654.

[42] The 2011 rulemaking was not very clear when it adopted an aggregation requirement for investments in accounts or pools with "identical trading strategies." Now, the 2013 Aggregation NPRM provides no guidance as to the meaning of "substantially identical trading strategies," nor does it explain how the concern about circumvention has changed from 2011 to 2013 that would explain the difference between "identical" and "substantially identical."

4. Independent Account Controller Exemption

We commend the Commission's inclusion of an IAC exemption that allows asset management companies to disaggregate the positions of customer accounts controlled by an IAC. We also commend the Commission for proposing to allow managers of employee benefit plans in proposed 150.4(b)(5) to qualify as IACs. We do have concerns, however, with two aspects of the proposed IAC exemption, described below.

4.1. The definition of IAC[43] should not be limited based upon CPO or CTA status.

The status of entities as registered, exempt or excluded CPOs or CTAs has nothing to do with the purpose behind the IAC: to provide for a safe harbor from aggregation requirements where there is no shared ownership or control between a parent advisor and sub-advisors. The Commission has not articulated a reason why IAC status should be limited to certain registrants on the one hand and certain exempt or excluded entities on the other. All pool operators and trading advisors should be able to avail themselves of the IAC exemption, irrespective of their status as registered, exempt or excluded.

4.2. The proposed IAC notice filing should not be required.

We question the utility of requiring asset managers to submit notice filings complying with proposed 150.4(c)(1) to claim the proposed 150.4(b)(5) IAC exemption. Under the Commission's current IAC exemption (17 CFR 150.3(e)), no such filing is required. The new proposed filing is unduly burdensome, particularly given the fact that we are aware of no abuses of the existing IAC exemption. In lieu of a notice filing, the Commission should consider a requirement to keep records on the eligible entity's and IAC's compliance with the conditions of the IAC exemption. If, however, the Commission requires a filing, it should allow for a simplified generic, omnibus filing that would provide the Commission notice that an eligible entity intends to use the exemption on a going-forward basis consistent with the terms of the exemption.

5. Summary

For the reasons stated above, we recommend that the Commission make the following changes in any final rulemaking adopting the 2013 Aggregation NPRM:

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[43] Proposed 150.1 defines "independent account controller" to mean a person (1) who specifically is authorized by an eligible entity, independently to control trading decisions on behalf of, but without the day-to-day direction of, the eligible entity; (2) over whose trading the eligible entity maintains only such minimum control as is consistent with its fiduciary responsibilities for managed positions and accounts to fulfill its duty to supervise diligently the trading done on its behalf or as is consistent with such other legal rights or obligations that may be incumbent upon the eligible entry to fulfill; (3) who trades independently of the eligible entity and of any other IAC trading for the eligible entity; (4) who has no knowledge of trading decisions by any other IAC; and (5) who is (i) registered as an FCM, an introducing broker, a CTA, or an associated person of any such registrant, or (ii) a general partner, managing member or manager of a commodity pool the operator of which is excluded from registration under Rule 4.5 or 4.13.

- The Commission should not adopt the proposed owned entity aggregation as proposed. Instead, the rules should be amended as discussed above in order to address the impact on passive investors that have no control over, or even knowledge of, the specific commodity derivatives trading activities of owned entities in which they have invested.

- The Commission should amend 150.4(b)(1)(iii) to only require passive investors to aggregate positions of a Commission regulation 4.13 exempt pool based on a 25% or more ownership interest when "the operator of which is exempt from registration *under §§ 4.13(a)(1) or (a)(2)*."

- The Commission should omit the requirement to aggregate investments in funds that follow "substantially identical trading strategies" from any final rulemaking.

- The Commission should expand the scope of entities eligible to become IACs, so no distinction is made based upon CPO or CTA registration, exemption or exclusion status. In addition, the IAC notice filing requirements should be eliminated.

* * *

We appreciate your consideration of our comments. We stand ready to provide any additional information or assistance that the Commission might find useful. Should you have any questions, please do not hesitate to contact Matt Nevins at 212-313-1176 or Michael Loesch at Norton Rose Fulbright at 202-662-4552.

Sincerely,

Timothy W. Cameron, Esq.
Managing Director, Asset Management Group
Securities Industry and Financial Markets Association

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Securities Industry and Financial Markets Association

Enclosure 3

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| asset management group

February 10, 2014
Melissa Jurgens
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington DC 20581

Re: Notice of Proposed Rulemaking – Position Limits for Derivatives (RIN 3038-AD11)

The Asset Management Group (the "AMG")[1] of the Securities Industry and Financial Markets Association ("SIFMA") appreciates the opportunity to provide the Commodity Futures Trading Commission (the "CFTC" or the "Commission") with our comments and recommendations relating to the Commission's "Position Limits for Derivatives" proposed rules ("2013 NPRM") promulgated under section 4a of the Commodity Exchange Act ("CEA" or the "Act"), as amended by section 737 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"). The AMG recognizes that regulatory action may be appropriate under certain circumstances in order to achieve the goals set forth in the CEA for setting position limits, namely to prevent market manipulation, protect against excessive speculation, ensure sufficient market liquidity for bona fide hedgers, and deter disruption to price discovery, including preventing price discovery from moving to foreign boards of trade ("FBOTs"), but continues to question whether position limits would achieve these goals, particularly as proposed under the 2013 NPRM.

AMG agrees that the Hunt brothers and Amaranth's speculative trading should "inform" a consideration of position limits rulemaking, but finds that many aspects of the Commission's proposal do little to directly address these two actors' manipulative activities while resulting in serious negative consequences for the commodity markets, AMG members, and our "Main Street" customers. We believe that under the CEA, the Commission must find that speculative position limits are "necessary" and "appropriate" and balance several countervailing statutory factors on a contract-by-contract basis before promulgating position limits rules. The Commission has not met these statutory requirements in promulgating the 2013 NPRM. We believe the Commission should therefore withdraw this proposal to make the needed findings. Nevertheless, if the Commission determines to proceed with the proposal, then it can better effectuate the goals of CEA section 4a by making the following changes:

[1] The AMG's members represent U.S. asset management firms whose combined assets under management exceed $20 trillion. The clients of AMG member firms include, among others, registered investment companies, ERISA plans, and state and local government pension funds, many of whom invest in commodity futures, options, and swaps as part of their respective investment strategies.

- modifying the proposed spot-month limits and withdrawing or increasing the non-spot-month position limit levels;
- provide designated contract markets ("DCMs") and swap execution facilities ("SEFs") more discretion with respect to aggregation requirements and other rules related to position limits;
- preserving the risk management exemption from speculative positions consistent with the terms of the CEA, as informed by administrative precedent and legislative history;
- granting counterparties to "commodity index contracts" an exemption for managing price risk associated with "commodity index contract" positions;
- exempting registered investment companies and ERISA accounts from speculative position limits; and
- extending grandfather relief to pre-existing positions.

1. ***Background on the AMG members' interest in speculative position limits regulations.***

The AMG's members represent U.S. asset management firms whose customers include, among others, registered investment companies, private funds, institutional accounts, ERISA plans and state and local government pension funds, many of whom invest in commodity derivatives as part of their investment strategies. Many of the funds and accounts that AMG members manage generally track a commodity index (*e.g.*, the Dow Jones-UBS commodity index). In addition to managing funds that specialize in commodities-related investments, many AMG members manage asset allocation funds that invest in the commodity markets, thereby enabling investors to obtain exposure to an asset class other than equities and bonds within one balanced and diversified portfolio.

Commodities represent a very small portion of assets under management by AMG members. Nevertheless, commodities represent an important asset class to investors. Through these funds and accounts that invest in commodity derivatives, AMG members offer a convenient, well-established mechanism for individuals, pension funds, retirement plans and other investors to diversify their overall investment portfolios with exposure to the commodity markets. Commodity-linked derivatives also allow prudently managed funds and accounts to mitigate economic risk, such as inflation and foreign exchange movements, and increase overall purchasing power.

Accordingly, members of the AMG have a strong interest in the proper functioning of commodity derivatives and commodities markets without undue restriction. The ability of AMG members to provide investor exposure to commodities as an asset class through these funds and accounts will be directly affected by any position limits rules adopted by the Commission. Any rules that are overly restrictive could adversely affect not only AMG members and the "Main Street" investors that invest in the products they manage, but also the U.S. commodity markets generally, potentially impairing price discovery and liquidity, which in turn could result in increased prices for all participants in the commodity derivatives market. In particular, restrictive limits could harm commodity producers and end-users who rely on these funds and accounts to take the other side of risk-reducing trades and provide a stable pool of liquidity. As the Commission determines whether and at what levels to set position limits, the AMG respectfully submits that it consider the important portfolio diversification mechanism that AMG members provide to investors seeking diversified exposure to commodities, and the adverse impact that position limits may have on AMG members and investors that invest in the products they manage.

2. *The Commission should make findings of necessity and appropriateness of its position limits regime based on a fact-intensive, contract-by-contract analysis.*

The Dodd-Frank Act placed several constraints on the Commission's exercise of CEA section 4a(a)(2) authority to impose position limits designed to ensure that position limits are imposed only when "necessary" and "appropriate" and that they strike an optimal balance among a series of factors.[2] With respect to the requirements to impose position limits when they are "necessary" and "appropriate" we refer to, and agree with, the joint International Swaps and Derivatives Association ("ISDA") and SIFMA comment letter submitted on the 2013 NPRM.[3] With respect to the statutory factors, the CEA requires that the Commission address six countervailing factors or goals as it promulgates position limit rules (the "Six Factors").[4] The Commission must strive to meet the "goals" of CEA section 4a(a)(2)(C) by "striv[ing] to ensure" that (Factor 1) "trading on foreign boards of trade in the same commodity will be subject to comparable limits" and that (Factor 2) "any limits to be imposed by the Commission will not cause price discovery in the commodity to shift to trading [to FBOTs]."[5] CEA section 4a(a)(3)(B) directs the Commission to balance four additional factors when exercising its CEA section 4a(a)(2) authority:

- (Factor 3) to diminish, eliminate, or prevent excessive speculation causing sudden or unreasonable fluctuations or unwarranted changes in price;
- (Factor 4) to deter and prevent market manipulation, squeezes, and corners;
- (Factor 5) to ensure sufficient market liquidity for bona fide hedgers; and
- (Factor 6) to ensure that the price discovery function of the underlying market is not disrupted.[6]

In order to establish speculative position limits that address these factors "to the maximum extent practicable," the Commission would need to consider each commodity

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[2] *See also* CEA section 4a(a)(1) and *ISDA v. CFTC*, No. 11-cv-2146 at 15 (D.D.C. Sept. 28, 2012), available at http://www.futuresindustry.org/downloads/USDC-DC_Position-Limits-Rule-Injunction_092812.pdf ("The precise question, therefore, is whether the language of Section [4a(a)(1)] clearly and unambiguously requires the Commission to make a finding of necessity prior to imposing position limits. The answer is yes.").

[3] *See* Letter to CFTC from ISDA and SIFMA Re: Notice of Proposed Rulemaking – Position Limits for Derivatives (RIN 3038-AD99) (Feb. 10, 2014), *available at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=59611&SearchText=.

[4] These Six Factors are separate from any other considerations, including a finding of necessity, required under CEA section 4a(a)(1) or any other consideration included in a finding of appropriateness. The Six Factors provide a purpose for the speculative position limits regime the Commission may impose under CEA section 4a(a)(2).

[5] CEA section 4a(a)(2)(C).

[6] CEA section 4a(a)(3)(B).

individually because the calculus required to fully maximize these factors would differ based on characteristics specific to each commodity contract market, as discussed further below.[7] The requirement to conduct a fact-intensive contract-by-contract analysis of which contracts should be subject to position limits also is supported by administrative precedent.[8] These factors also apply to rules that affect the efficacy of position limits. We believe the Commission must analyze each exercise of discretion it proposes to undertake in establishing position limits under these Six Factors.

2.1. The AMG agrees that the Hunt brothers and Amaranth's speculative trading should "inform" a consideration of position limits.

While the 2013 NPRM proposes to issue position limits rules without a finding of necessity, "in an abundance of caution," it makes a general finding of necessity citing two historic episodes: (1) Hunt brothers (1979-1980) and (2) Amaranth (2006). Amaranth and the Hunt brothers shared one important feature in common: both were "pure speculator[s]"[9] that did not have financial or physical exposures that offset the risk exposures created by their extremely large natural gas or silver derivatives positions (respectively). The Commission claims that these two firms' speculative trading "inform" the Commission's proposal.[10]

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[7] We note that in our interpretation of CEA section 4a(a)(2)'s "as appropriate" language, the Commission must make a fact-driven interpretation that position limits are appropriate and, if so, that the limits it has selected are also appropriate, regardless of whether the Commission must make a finding of necessity before establishing position limits.

[8] In the 2013 NPRM, the Commission cites a rulemaking from 1981 ("1981 Rulemaking") as supporting its assertion that the Commission only has "to determine that excessive speculation is harmful to the market and that limits on speculative positions are a reasonable means of preventing price disruptions in the marketplace that place an undue burden on interstate commerce" to meet the requirements of CEA section 4a(a)(1). 78 Fed. Reg. at 75,683 at fn. 34, *citing* 46 Fed. Reg. at 50,940. The 2013 NPRM ignores, however, that the 1981 Rulemaking imposed speculative position limits only after a fact-intensive inquiry into the characteristics of individual contract markets in order to determine limits "most appropriate" for "an individual contract market." 46 Fed. Reg. at 50,940 ("[CEA section 4a] represents an express Congressional finding that excessive speculation is harmful to the market, and a finding that speculative limits are an effective prophylactic measure." Consistent with this, the Commission promulgated rules directing DCMs to "employ their knowledge of their individual contract markets to propose the position limits they believe most appropriate."). In other words, DCMs' deployment of "knowledge" of an "individual contract market" allowed DCMs to implement position limits "most appropriate" for that market. Furthermore, in the 1981 Rulemaking, the Commission found that specific speculative position limits designed to combat excessive speculation should be carefully calibrated so as not to "interfere with normal trading patterns or significantly impact market liquidity or pricing efficiency… [or] cause [the preponderance] of speculative traders to conduct their trading in a foreign futures market." 46 Fed. Reg. at 50,940-50,941 ("The Commission is aware that speculation is often an important contributing factor to market liquidity and pricing efficiency. […] In this respect, the Commission indicated that in its review of proposed [DCM] speculative limits, it will consider the historical distributions of speculative positions considering, among other things, recent trends in position patterns, the frequency of positions occurring at different levels and the levels at which occur the preponderance of speculative positions normally observed in the market.").

[9] *Id*. at 75,692 at note 103 ("Amaranth was a pure speculator that, for example, could neither make nor take delivery of physical natural gas."). "The Hunt brothers were speculators who neither produced, distributed, processed nor consumed silver." *Id.* at 75,686.

[10] *Id.* at 75,685.

The Hunt brothers exemplify two forms of manipulation: cornering a physical market to benefit a large leveraged derivatives position and the short squeeze.[11] Amaranth is an example of "banging the close" manipulation[12] coupled with "excessive speculation" in the form of large calendar spread speculative positions that, at times, amounted to as much as 40% of all of the open interest on the New York Mercantile Exchange ("NYMEX") for the winter months (October 2006 through March 2007)."[13]

We agree that these two firms' abusive trading could be instructive and provide commenters the ability to compare the Commission's proposal with actual undesirable trading activity (as opposed to theoretical harms addressed by "prophylactic" limits). However, when we compare Amaranth or the Hunt brothers' trading to the 2013 NPRM's provisions, we find that many key aspects of the proposal go far beyond preventing such market abuse while imposing significant, real harm to the commodity and commodity derivatives markets and market participants. This harm is precisely what Congress sought to avoid in requiring the Commission to make a finding of appropriateness in support of position limits, including careful consideration of the Six Factors for each contract subject to position limits. We note, finally, that neither Amaranth nor the Hunt brothers were subject to an existing regulatory regime that aligned their incentives with investors, limited their leverage, required them to diversify their holdings, and required them to provide their investors transparency.

2.2. The Commission already has the power to address the purposes of CEA section 4a without a restrictive position limits regime.

The Commission's exercise of its CEA section 4a authority to impose "necessary" and "appropriate" speculative position limits should take into account its ability to prevent excessive speculation and manipulation in the absence of new speculative position limits. Concerns regarding manipulation and excessive speculation are already addressed through DCMs' and SEFs' position limits and accountability rules.[14] DCMs' (or SEFs') position accountability rules can prevent manipulative or potentially manipulative conduct, or "excessive speculation," far before a position limit is reached while not imposing unneeded constraints on large positions that

[11] "Position limits would help to deter and prevent manipulative corners and squeezes, such as the silver price spike caused by the Hunt brothers and their cohorts in 1979–80." 78 Fed. Reg. at 75,683. The Commission defined both manipulative corners and squeezes: "A market is 'cornered' when an individual or group of individuals acting in concert acquire a controlling or ownership interest in a commodity that is so dominant that the individual or group of individuals can set or manipulate the price of that commodity. In a short squeeze, an excess of demand for a commodity together with a lack of supply for that commodity forces the price of that commodity upward." *Id.* at 75,685.

[12] *CFTC v. Amaranth*, Complaint for Injunctive and Other Equitable Relief under the Commodity Exchange Act, CA 07-CIV-6682, July 25, 2007, available at http://www.cftc.gov/ucm/groups/public/@lrenforcementactions/documents/legalpleading/enfamaranthcomplaint072507.pdf.

[13] Excessive Speculation in the Natural Gas Market, Staff Report, Permanent Subcommittee on Investigations of the Senate Committee on Homeland Security and Governmental Affairs, U.S. Senate, at 6 and 51-52 (June 25, 2007), available at http://www.levin.senate.gov/imo/media/doc/supporting/2007/PSI.Amaranth.063507.pdf ("Amaranth Report").

[14] *Speculative Position Limits-Exemptions From Commission Rule 1.61; Comex Proposed Amendments to Rules 4.47 and 4.48*, 57 Fed. Reg. 29,064, 29,065-29,066 (June 30, 1992). *See also e.g.*, CME Rulebook, Rule 560, available at http://www.cmegroup.com/rulebook/CME/I/5/5.pdf.

pose no risk.[15] Violations of these position limits are violations of federal law under CEA section 4a(e). The Commission also has surveillance capabilities (e.g., large futures and swaps trading reports,[16] swap data reporting and recordkeeping requirements,[17] "special call" authority,[18] etc.) that provide it granular visibility into the commodity derivatives and cash market activities (upon special call) of all market participants to prevent manipulation and detect excessive speculation. This increased visibility is augmented by automated surveillance systems,[19] the Commission's emergency powers under CEA section 8a(9), new Dodd-Frank anti-manipulation and disruptive trade practices authority,[20] and the Commission's whistleblower program – all of which vastly increase the probability of detecting, preventing, and taking effective action against manipulative or potentially disruptive speculative activity.

3. *Comments on specific aspects of the Commission's proposal*

If, notwithstanding our comments above, the Commission adopts speculative position limits, then it should make significant changes to the rulemaking in order to better address the CEA's Six Factors. Below, we provide comments aimed at achieving the goals embodied in CEA section 4a in light of Amaranth and the Hunt brothers. Our suggestions, if implemented, form an alternative to the Commission's proposal that would be less costly in terms of compliance costs, result in less negative consequences on liquidity and price discovery, and provide the same benefit in terms of reduced likelihood for excessive speculation and manipulation.

3.1. The proposed spot-month position limits are inappropriate because they fail to take into account the characteristics of each contract and should therefore be withdrawn or significantly altered.

3.1.1. The Commission's spot-month limit formula is arbitrary and the Commission should adopt an approach that takes into account the characteristics of each commodity market or defer to DCMs and their knowledge of individual markets to determine appropriate spot-month position limit levels.

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15 *See e.g.,* CBOT Rulebook, Rule 560, available at http://www.cmegroup.com/rulebook/CBOT/I/5/5.pdf.

16 *See* 17 CFR parts 15, 16, 17, 18, and 20.

17 *See* 17 CFR part 45.

18 *See e.g.*, 17 CFR 18.05 and 17 CFR 20.6.

19 *See* CFTC Market Surveillance Program, http://www.cftc.gov/IndustryOversight/MarketSurveillance/CFTCMarketSurveillanceProgram/tradepracticesurveillance (last visited Jan. 26, 2013) ("Trade violation detection software will perform sophisticated pattern recognition and data mining to automate basic trade practice surveillance. Among other things, TSS will provide Commission staff with the necessary tools to conduct inter-exchange and cross border surveillance of related contracts; to detect novel and complex abusive practices in today's high-speed, high volume global trading environment; and to perform timely and customized analyses of all trading activity as well as complex, value-added surveillance in significant cases.").

20 *See* CEA section 4c.

The Commission proposes to set spot-month position limits at 25% of estimated deliverable supply under proposed 150.2(e)(3). If a commodity market has consistently liquid cash markets, greater storage capacity, and more reliable supply, it would be unlikely to be subject to a short squeeze or susceptible to cornering, even with position limits set at higher than 25% of estimated deliverable supply.[21] We encourage the Commission to provide a means by which more appropriate spot-month position limit levels may be established. We therefore recommend the Commission either adopt an approach that takes into account the characteristics of each commodity market or, consistent with the terms of CEA section 4a and administrative precedent, that the Commission defer to DCMs and their knowledge of individual markets to determine appropriate spot-month position limit levels.

3.1.2. The Commission's spot-month limit determination process should be explained further in order to avoid arbitrary and potentially harmful outcomes.

Under proposed 150.2(e)(3), DCMs listing physical-delivery referenced contracts would be required to submit, every two years, estimates of deliverable supply. The Commission indicates that it will defer to DCMs' estimate of deliverable supply unless it "determines to rely on its own estimate."[22] The Commission gives no indication as to when or under what standard it will determine to "rely on its own estimate," leaving open the possibility of arbitrary determinations that could be harmful to the markets. We recommend the Commission provide specific criteria both for when it determines not to rely on the DCMs' estimate and as to how it will formulate its own estimates of deliverable supply in such circumstances. We also recommend that the Commission estimates be subject to notice and comment.

3.1.3. Market participants should be permitted to net their cash-settled and physically-settled positions in a spot month in order to accurately reflect their aggregate spot-month positions.

Under proposed 150.2(a), the Commission proposes separate federal physical-delivery spot-month position limits and aggregate cash-settled position limits. The Commission has not demonstrated that these separate limits are necessary. We understand one motivation behind this proposal is a theoretical concern that a market participant could establish an unrestricted long position in the physical-delivery contract held through the end of the spot month resulting in a delivery obligation for its counterparties that is offset with a cash-settled position. Market discipline is generally sufficient to deter such trading behavior. While maintaining the long physical-delivery position could be used to effect a short squeeze, the trader in this scenario would not benefit from any price spike caused by a short squeeze – indeed, their short positions would result in substantial losses. More importantly, the danger to market integrity under this scenario is adequately addressed by DCMs' and futures commission merchants' rules and by procedures designed to ensure that market participants that hold a long or short position into a

[21] *See* 17 CFR 1.61(a)(2)(1991).

[22] 78 Fed. Reg. at 75,728; proposed 150.2(a)(3)(i).

delivery period actually have the ability to take or make delivery.[23] Conversely, allowing market participants to net physically-settled and cash-settled contracts would more accurately reflect net positions. We see no reason why such netting should not be permitted.

3.2. The Commission's non-spot-month limit formula is arbitrary and the Commission should adopt an approach that takes into account the characteristics of each commodity market or defer to DCMs and their knowledge of individual markets to determine appropriate non-spot-month position limit levels.

The Commission proposes under 150.2(e)(4) to use the same formula ("open interest formula") regardless of the characteristics of the market.[24] The Commission first proposed the open interest formula in 1992 for "legacy" agricultural commodities subject to federal speculative position limits.[25] Because the Commission has not undertaken an analysis of the individual referenced contract commodity markets, its proposed non-spot-month position limits would be inappropriate for all referenced contracts. In the same 1992 rulemaking the Commission stated that the "fundamental tenet in the Commission's setting of speculative position limits is that such limits must 'be based upon the individual characteristics of a specific contract market.'"[26] The Commission also noted that "the limits which are appropriate for certain types of commodities, such as agricultural commodities, may [not] be appropriate for other tangible or intangible commodities."[27] The Commission suggested different limits might be appropriate for non-agricultural commodities because of the "depth of the underlying cash market and ease of arbitrage [that] differ from agricultural markets."[28] For example, with respect to energy and metals commodities, the Commission found in 1992 that because these commodities generally exhibited "a high degree of liquidity," position accountability rules – rather than limits - would be adequate to address concerns relating to excessive speculation.[29]

Notwithstanding these countervailing considerations, the Commission now proposes to apply the same open interest formula to all 28 referenced contract commodities. It is unclear how the misgivings the Commission had in 1992 have been overcome. If anything, the agricultural markets now resemble the energy and metals markets of 1992 in terms of greater liquidity, which would provide support for a less restrictive formula under Commission

[23] *See* e.g., NYMEX Rulebook, Rule 716, available at http://www.cmegroup.com/rulebook/NYMEX/1/7.pdf ("each clearing member shall be responsible for assessing the account owner's ability to make or take delivery for each account on its books with open positions in the expiring contract. Absent satisfactory information from the account owner, the clearing member is responsible for ensuring that the open positions are liquidated in an orderly manner prior to the expiration of trading.").

[24] The formula would set single-month and all-months position limits at 10% of open interest for the first 25,000 contracts in a referenced contract market and 2.5% thereafter. Proposed 150.2(e)(4).

[25] *See* Revision of Federal Speculative Position Limits, Proposed Rules, 57 Fed. Reg. 12,766 (Apr. 13, 1992).

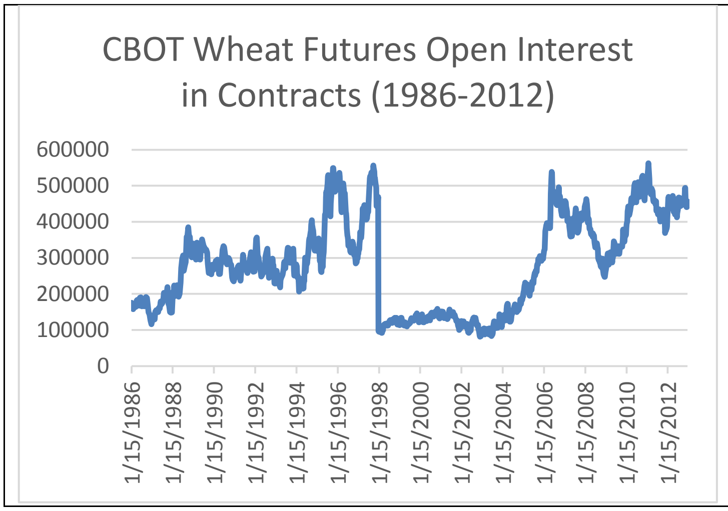
[26] *Id*. at 12,770, *citing* 52 Fed. Reg. at 6,815.

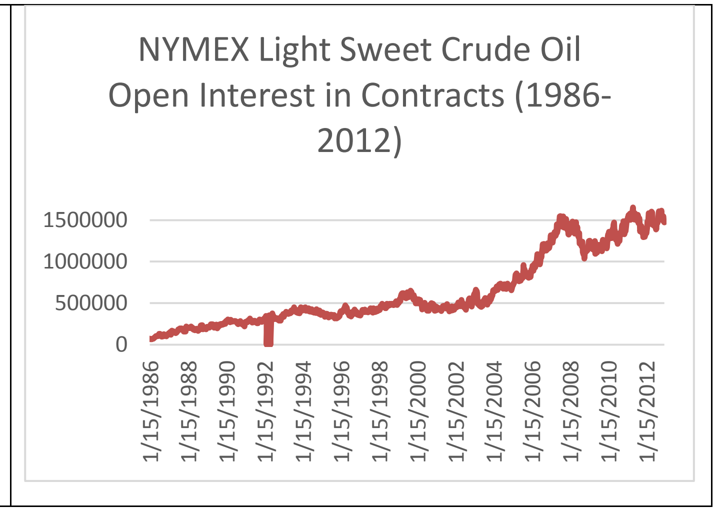
[27] *Id*.

[28] *Id*. at n. 14.

[29] 57 Fed. Reg. at 29,065-29,066 (June 30, 1992) (also finding that speculative position limits are not necessary in commodities that "have substantial forward markets that readily are arbitraged with the futures of [sic] option markets.").

administrative precedent. Take, for example, the following levels of open interest (indicative of liquidity) in the CBOT Wheat and NYMEX Light Sweet Crude Oil futures contracts:[30]





We note further that the Commission's proposed non-spot-month position limit formula results in a disparate impact that demonstrates this formula is wholly inappropriate. The limits the Commission is proposing would have widely different effects on different commodities. For example, Table 11 to the 2013 NPRM shows that in COMEX Copper referenced contracts, 16 unique enterprises would have been over the Commission's speculative position limit levels in 2011-2012. In contrast, in many other referenced contract markets, the number of overages is few. Is this because there is more "excessive speculation" in COMEX Copper than in NYMEX Henry Hub Natural Gas, for example (which Table 11 describes as having zero non-spot-month overages)? It does not attempt to explain that there is any rationale behind this disparate impact. The Commission does not explain whether any, all, or some of the overages it has indicated in Table 11 result from speculative positions or from bona fide hedging positions or from a combination of the two. Essentially, what Table 11 indicates is that the impact of the Commission's non-spot-month position limits is random – demonstrating that the non-spot-month formula and the limits that result from it are entirely arbitrary and have no relationship to preventing excessive speculation or manipulation. If the Commission is to set non-spot-month limits at arbitrary levels, it should do so at very high levels in order to prevent the types of harms unduly restrictive position limits can have, as reflected in the statutory Six Factors.

Finally, the Commission's proposed non-spot-month position limits do not increase the likelihood of preventing the excessive speculation or manipulative trading exemplified by Amaranth or the Hunt brothers relative to the status quo. We note that the large non-spot-month positions of Amaranth and the Hunt brothers could have been addressed by DCMs and SEFs under position accountability rules.[31] In the case of Amaranth, NYMEX did, in fact, cap

[30] Data taken from the CFTC's Historical Compressed Commitment of Traders Report, http://www.cftc.gov/MarketReports/CommitmentsofTraders/HistoricalCompressed/index.htm (last visited Jan. 26, 2014).

[31] CEA sections 5(d)(5)(A) and 5h(f)(6)(A) ("To reduce the potential threat of market manipulation or congestion, especially during trading in the delivery month," a DCM or SEF shall adopt for each contract, "as is necessary and appropriate, position limitations or position accountability for speculators.").

Amaranth's speculative positions on its exchange. Amaranth responded by taking advantage of a regulatory arbitrage opportunity: "[i]n August 2006, Amaranth traded natural gas on [the then unregulated InterContinental Exchange ("ICE") OTC platform] rather than NYMEX so that it could trade without any restrictions on the size of its positions."[32] The Amaranth Report recommended therefore, most pertinently, that: (1) the Congress should give the Commission authority to regulate electronic OTC markets (e.g., ICE at the time)[33] and (2) the Commission "should monitor aggregate positions on NYMEX and ICE for all of the months in which contracts are traded, not just for contracts near expiration."[34] This concern from 2006 would not exist under today's rules. Under the Commission's part 37 rules relating to SEFs it now has authority over all multilateral derivatives trading platforms (ICE would have been a SEF) and the Commission's expanded part 20 and its part 45 reporting rules now enable it to monitor all futures and swaps positions. Notably, the Amaranth Report did not recommend that the Commission establish non-spot-month position limits for natural gas, the 28 referenced contract commodities, or all physical commodity derivatives.

In order to ensure that the Commission's speculative position limits "to the maximum extent practicable" achieve the goals of CEA section 4a, AMG recommends therefore that the Commission take one of three non-exclusive actions: (1) decline to adopt non-spot-month position limits; (2) set non-spot month limits at levels where they are unlikely to affect any persons until the Commission is able to develop a factual record to justify restrictive limit levels under the Six Factors and other purposes of CEA section 4a; or (3) re-propose its speculative position limits proposal after utilizing the expertise and resources of DCMs and SEFs to determine "appropriate" non-spot-month position limit levels as the Commission has done traditionally.[35]

3.3 DCMs and SEFs should be given more discretion to determine appropriate aggregation and other requirements relating to speculative position limits.

The 2013 NPRM proposes to limit the discretion of DCMs and SEFs ("exchanges" collectively) in their administration of speculative position limits in two important ways including:

(1) under proposed 150.5(a)(5), aggregation requirements must "conform to" those of the Commission under proposed 150.4; and

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[32] Amaranth Report at 6.

[33] *Id*. at 8.

[34] *Id*. Significantly, the Amaranth Report did not recommend changes to the Commission's position limits regime. Its recommendation that the Amaranth problem be addressed, in part, by statutory authority for the Commission to regulate electronic OTC markets was achieved through the enactment in 2008 of the Food, Conservation and Energy Act of 2008, Public Law 110-246, 122 Stat. 1624 (June 18, 2008).

[35] In 1981, the Commission finalized rules directing DCMs to "employ their knowledge of their individual contract markets to propose the position limits they believe most appropriate." Establishment of Speculative Position Limits, 46 Fed. Reg. 50,938, 50,940. In other words, DCMs' deployment of "knowledge" of an "individual contract market" enabled DCMs to implement position limits "most appropriate" for that market. *Id.* The Commission also stated that it "endorse[d]" the "concept" that "the exchanges are in the best position to determine the most efficacious level at which position limitations may be established." *Id*. at n. 5. *See also* 17 CFR 1.61(a)(2) (1981).

(2) under proposed 150.5(a)(2)(i), limiting their discretion to defining the scope of hedge and other exemptions to those that conform to the Commission's definitions.

As discussed above, the Commission has traditionally followed the principle that exchanges have superior knowledge of individual contract markets enabling them to implement position limits and related aggregation requirements and exemptions "most appropriate" for that market.[36] Consistent with this principle, we urge the Commission to provide exchanges broader discretion in determining aggregation rules and exemptions, subject to Commission oversight. Providing the exchanges this broader discretion would enable them to more effectively and efficiently further the purposes of CEA section 4a by tailoring these requirements to the individual commodity contract markets. The need for broader exchange discretion is particularly warranted in the non-referenced contracts, including excluded commodities, that the Commission has not considered in any depth in this rulemaking. We note finally that the Commission has not considered the costs borne by exchanges and market participants from the prescriptive approach to exchange-administered position limits, including exchange aggregation notice filing and application requirements conforming to proposed 150.4(c)(1) and (c)(2). For example, under proposed 150.4(c), the Commission would require notice and application filings for market participants seeking an aggregation exemption. The Commission should allow and encourage exchanges to tailor such requests for aggregation relief to the markets they regulate.[37]

3.4 Bona fide hedging exemption.

3.4.1. The Commission should preserve the risk management exemption.

Commission staff historically provided a bona fide hedging exemption for positions that offset risks related to swaps or similar OTC positions involving both individual commodities and commodity indexes ("risk management exemption").[38] These exemptions were subject to specific conditions to protect the market, including: (1) the futures positions must offset specific price risk; (2) the dollar value of the futures positions must be no greater than the dollar value of the underlying risk; and (3) the futures positions must not be carried into the spot month.[39]

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[36] In 1981, the Commission finalized rules directing DCMs to "employ their knowledge of their individual contract markets to propose the position limits they believe most appropriate." 46 Fed. Reg. at 50,940. This included aggregation and exemption rules. *See* 17 CFR 1.61 (1982).

[37] AMG is commenting separately on the Commission's aggregation proposal, Aggregation of Positions, 78 Fed. Reg. 68,946 (Nov.15, 2013).

[38] "Position Limits and the Hedge Exemption, Brief Legislative History," Testimony of General Counsel Dan M. Berkovitz, Commodity Futures Trading Commission, July 28, 2009, available at http://www.cftc.gov/PressRoom/SpeechesTestimony/berkovitzstatement072809.

[39] *Id. See also* CFTC Form 40, Part B, Item 3 and Schedule 1 (defining "hedging" as including "asset/liability risk management, security portfolio risk, etc.").

The Commission proposes to eliminate the risk management exemption on the basis of CEA section 4a(c)(2)'s definition of a "bona fide hedging transaction or position" ("statutory definition"), which was added by Dodd-Frank. CEA section 4a(c)(2) was modeled on 17 CFR 1.3(z) ("regulatory definition") with one important difference: the statutory definition of a "bona fide hedging transaction or position" did not include the term "normally" in presenting the "temporary substitute criterion," which provides that a bona fide hedge position should "normally represent[] a substitute for transactions made or to be made or positions taken or to be taken at a later time in a physical marketing channel." (emphasis added) The Commission proposes to interpret this omission as meaning that a bona fide hedging position must represent a "substitute for transactions made or to be made in a physical marketing channel."[40] In other words, the hedge position is "a temporary substitute for a cash transaction that will occur later."[41]

By eliminating the risk management exemption, the Commission's speculative position limits rules would go beyond deterring excessive speculation and manipulation and would have the effect of deterring and constraining liquidity by market participants with non-speculative positions in commodity derivatives – essentially deterring non-speculative, prudent risk management. Commodity funds and asset allocation funds, for example, utilize commodity derivatives in active or passive management strategies in order to provide diversified, commodity-based returns to their clients and to mitigate economic risk. Reduced liquidity would also result in increased prices for all participants in the commodity derivatives market.

We urge the Commission to reconsider eliminating the risk management exemption. A risk management position represents a non-speculative, flat-risk position and should therefore be exempt from speculative position limits. The risk management exemption also encourages the provision of liquidity across financial and physical markets and therefore furthers the goals of promoting liquidity for bona fide hedgers and price discovery. We note that neither Amaranth nor the Hunt brothers used the risk management exemption and therefore its elimination is not warranted if those two actors' trading activity is to provide any guidance to the Commission as to the regulatory changes that it should implement. Indeed, speculative position limits under CEA section 4a are intended to target excessive speculation and manipulation,[42]and risk management positions present zero risk of either. As discussed below, we do not believe the elimination of the risk management is compelled by CEA section 4a(c)(2) and the Commission has ample authority to exempt risk management positions under CEA section 4a(a)(7).

3.4.1.1. The Commission has ample authority under CEA section 4a(a)(7) to exempt risk management positions.

Representative Lucas, the Ranking Member of the House Agriculture Committee that authored CEA section 4a(c)(2)'s bona fide hedging language strongly cautioned against overly

[40] 78 Fed. Reg. at 75,709.

[41] *Id.* at 75,686 at fn. 70.

[42] CEA section 4a(a)(1). CEA sections 4a(a)(4) and 4a(a)(5) provide further evidence that Congress wanted to ensure that market participants could net price risk in related products, "significant price discovery function" and "economically equivalent" swaps, with futures price risk.

strict position limits with overly narrow exemptions.[43] Representative Lucas urged the Commission to "make use of the exemptive authority granted by the [CEA] to avoid establishing position limits which would force widely-held funds or firms to divest their current holdings in highly regulated products."[44] Congress did not intend, he continued, that the Commission establish speculative position limits in a manner that "impair[s] price discovery for commercial producers and their counterparties, and cause unnecessary harm to the futures markets and small investors."[45]

Under CEA section 4a(a)(7), the Commission may exempt any persons or transactions from position limits. Proposed 150.3(e)(2) provides that the Commission "may request" relief from the Commission for "risk-reducing practices commonly used in the market." The Commission does not explain specifically under what circumstances this relief may be granted.

We believe the Commission should provide for a means to obtain reliable and predictable relief for risk management positions under the Commission's CEA section 4a(a)(7) authority. The Commission should provide for a risk management position exemption under the conditions of the Commission's past risk management exemption, i.e., (1) the exempted positions must offset specific price risk; (2) the dollar value of the futures positions must be no greater than the dollar value of the underlying risk; and (3) the futures positions must not be carried into the spot month. These conditions ensure the exemption would not be abused. The Commission could grant such relief in a manner similar to the bona fide hedging exemption in proposed 150.3(a)(1)(i).

3.4.1.2. Eliminating the risk management exemption is not compelled by CEA section 4a(c)(2).

The Commission's rationale in proposing to eliminate the risk management exemption is based on the omission of a single word in CEA section 4a(c)(2)'s "bona fide hedging transaction or position" definition. We urge the Commission to reconsider its interpretation of the omission of the term "normally" in CEA section 4a(c)(2)'s temporary substitute clause and to interpret that clause as it has been traditionally interpreted under applicable administrative precedent: as a non-restrictive condition providing further indication that the risks being hedged under the exemption arise from operation of a commercial enterprise.

In the Commission's 1987 "Clarification of Certain Aspects of the Hedging Definition," ("1987 Clarification"), the Commission provided background on the meaning of the temporary substitute criterion of 17 CFR 1.3(z).[46] In the 1987 Clarification, the Commission pointed out

[43] Letter dated December 16, 2010 from Congressman Spencer Bachus and Congressman Frank Lucas to the Honorable Timothy Geithner, the Honorable Gary Gensler, et al. (the "Bachus/Lucas Letter"), available at http://online.wsj.com/public/resources/documents/bachus.pdf ("Overly prescriptive position limits would drain existing liquidity from the capital markets, impair price discovery for commercial producers and their counterparties, and cause unnecessary harm to the futures markets and small investors.").

[44] *Id*.

[45] *Id*.

[46] Clarification of Certain Aspects of the Hedging Definition, 52 Fed. Reg. 27,195, 27,196 (July 20, 1987).

that in first proposing a definition of bona fide hedging position in 1977, the Commission did not include the term "normally."[47] The Commission added the term "normally" in response to commenters to "provide *further* indication" that the temporary substitute criterion was *not* to be "construed as a restrictive, *necessary condition* for the bona fide hedging" exemption (emphasis added). In 1977, the Commission explained that the intention behind the proposed definition of bona fide hedging position was "to set out the basic conditions which must be met by a bona fide hedging transaction or position; i.e. that it must be economically appropriate to risk reduction, such risks must arise from operation of a commercial enterprise, and the price risk fluctuations of the futures contract used in the transaction must be substantially related to fluctuations of the cash market value of the assets, liabilities, or services being hedged."[48] The Commission has not, until 2011, intended to make the temporary substitute criterion a necessary requirement for the bona fide hedging exemption.

Similarly, in its 1987 "Guidelines for Risk Management Exemptions," the Commission noted that the concerns it sought to address with speculative position limits related primarily to "derivative market positions lacking an offsetting cash or derivative market position." For market participants claiming a risk management exemption, they have an offsetting derivatives position and should be able to claim an exemption for managing these risks.

3.5 The AMG welcomes exclusion of "commodity index contracts" but recommends that counterparties to "commodity index contracts" be provided an exemption for managing commodity index contract position risks.

3.5.1. "Commodity index contract" exclusion.

We welcome the exclusion of "commodity index contracts"[49] from the proposed definition of "referenced contract." We agree with the Commission's rationale for this exclusion. Commodity index contracts do not "involve a separate and distinct exposure to the price of a referenced [] contract's commodity" price.[50] This provision benefits many asset managers and their customers who invest in such products in order to gain price exposure to a diversified array of commodities over a diverse set of maturities. The liquidity added to commodity markets by these investments is particularly beneficial in longer dated maturities where liquidity can be scarce. Commercial, bona fide hedgers that might use long-dated commodity derivatives can more cost-effectively establish long-term hedges because of the liquidity that commodity index contracts provide.

3.5.2. The Commission should provide a risk management exemption for positions hedging the price risk of "commodity index contracts."

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[47] *Id*. citing 42 Fed. Reg. at 14,833.

[48] *Id*.

[49] "Commodity index contract means an agreement, contract, or transaction that is not a basis or any type of spread contract, based on an index comprised of prices of commodities that are not the same or substantially the same." Proposed 150.1.

[50] Federal Speculative Position Limits for Referenced Energy Contracts and Associated Regulations, 75 Fed. Reg. 4,144, 4,153 (Jan. 26, 2010).

As discussed above in section 3.4, we urge the Commission to reinterpret its bona fide hedging exemption to include risk management positions, inclusive of price risk associated with commodity index contract positions. If it declines to do so, we urge the Commission to extend a risk management exemption for the limited purpose of managing the price risk associated with commodity index contract positions, consistent with the intention behind excluding commodity index contract positions. We note that currently, counterparties to commodity index swaps can remain in compliance for exceeding a position limit based on a position hedging "commodity index contract" price risk under DCM risk management exemptions. We believe that counterparties to commodity index swaps should be able to manage the risk of these contracts without these positions counting against their limits.

3.5.3. Benefits arising from commodity index investment and the costs borne by deterring commodity index investment.

AMG believes that evidence supports the many benefits offered to commodity markets by commodity index funds and accounts, whose long-term diversified investments enhance stability, price discovery and producer hedging. Recognizing these benefits, Senator Blanche Lincoln stated in a July 16, 2010 Senate Colloquy that commodity index participation, in addition to the benefits it provides investors, may "also serve to provide agricultural and other commodity contracts with the necessary liquidity to assist in price discovery and hedging for the commercial users of such contracts."[51]

These considerable benefits will be significantly reduced if the Commission determines not to grant the relief we have requested. Our members noted that leading up to the effective date of the Commission's vacated part 151 position limits rules (a rulemaking that also excluded "commodity index contracts" and also did not provide for an exemption for positions offsetting commodity index contract price risk), our members noticed less liquidity and noticeably worse pricing for commodity index swaps. These results were due to the expectation of counterparties that our members trade with that their ability to manage the risk offsetting commodity index swaps would be hindered under the anticipated part 151 rules. Our members would expect to incur similar costs under the Commission's new proposed rules. Furthermore, during the run-up to the effective date of the Commission's vacated part 151 position limits rules, our members were finding that they needed to transact with additional counterparties in order to trade commodity index swaps as their counterparties were concerned with hitting limits. As a result, many of our members were preparing to initiate trades with less creditworthy counterparties in order to source liquidity.

We note finally that neither Amaranth nor the Hunt brothers were in any way involved in commodity index swaps. Reducing the ability of commodity index swap counterparties to

[51] Blanche Lincoln, Senate Colloquies, July 16, 2010: "I wish to also point out that section 719 of the conference report calls for a study of position limits to be undertaken by the CFTC. In conducting that study, it is my expectation that the CFTC will address the soundness of prudential investing by pension funds, index funds and other institutional investors in unleveraged indices of commodities that may also serve to provide agricultural and other commodity contracts with the necessary liquidity to assist in price discovery and hedging for the commercial users of such contracts."

manage the risk associated with their swap positions therefore would present no beneficial effect on the Commission's ability to prevent the type of trading conducted by these two bad actors.

3.6. The Commission should exempt registered investment companies and ERISA accounts from speculative position limits.

Registered investment companies ("RICs") and ERISA accounts are subject to stringent regulatory requirements that ensure that the incentives of the investment adviser are aligned with those of the customers.[52] These rules and regulations ensure that RICs and ERISA accounts do not engage in the kind of "excessive speculation" or manipulative trading exemplified by Amaranth or the Hunt brothers. Unlike RICs and ERISA accounts, Amaranth was an unregulated private fund.[53] Amaranth had a leverage ratio that ranged from five to eight times capital, which resulted in more market pressure when Amaranth was forced to unwind positions.[54] Being unregulated, Amaranth's investors had little transparency in how dangerously exposed Amaranth was to natural gas prices.[55] Not subject to diversification requirements, Amaranth had extreme exposures to just a few natural gas settlement prices.[56]

In contrast to Amaranth and the Hunt brothers, RICs and ERISA accounts are subject to existing regulatory regimes that align their incentives with investors, limit their leverage, require them to diversify their holdings, and require them to provide transparency to their investors. RICs are required to comply with all regulations and related guidance under the Investment Company Act of 1940 (the "Investment Company Act"), including those regarding counterparty limits, liquidity and asset coverage and the use of leverage. The Investment Company Act limits the amount of leverage that a RIC may obtain, including through the use of derivatives, by requiring the fund to segregate liquid assets or hold offsetting positions on its books in an equivalent amount.[57] Unleveraged funds significantly reduce market pressure in the event of any forced unwinding of positions, and are substantially less likely to liquidate due to market movements than leveraged funds like Amaranth.

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[52] *See* letter dated December 16, 2010 from Congressman Spencer Bachus and Congressman Frank Lucas to the Honorable Timothy Geithner, the Honorable Gary Gensler, et al. (the "Bachus/Lucas Letter"), available at http://online.wsj.com/public/resources/documents/bachus.pdf ("We hope that the [CFTC] will make use of the exemptive authority granted by the [CEA] to avoid establishing position limits which would force widely-held funds or firms to divest their current holdings in highly regulated products. Overly prescriptive position limits would drain existing liquidity from the capital markets, impair price discovery for commercial producers and their counterparties, and cause unnecessary harm to the futures markets and small investors.").

[53] Amaranth Report at 57.

[54] *Id.* at 58.

[55] *See* The Amaranth Debacle: A Failure of Risk Measures or a Failure of Risk Management?, Ludwig B. Chincarini, Journal of Alternative Investment (2007), available at http:// pages.pomona.edu/~lbc04747/pubs/pub10.pdf.

[56] *See e.g.,* Amaranth Report at 60-64.

[57] Section 18(f) of the Investment Company Act; *see also* Securities Trading Practices of Registered Investment Companies, Investment Company Act Release No. 10666 (Apr. 18, 1979); Merrill Lynch Asset Management, L.P., SEC No-Action Letter (July 2, 1992); Dreyfus Strategic Investing & Dreyfus Strategic Income, SEC No-Action Letter (June 22, 1987).

RICs electing to be "diversified companies" under the Investment Company Act are required to follow strict diversification requirements, including restrictions against investing more than 5% of total capital in any single issuer, and requirements to invest at least 75% of total assets in cash and securities.[58] In addition, RICs must maintain at least 85% of their assets as liquid investments, are required to calculate and publish net asset values and disclose substantial information about their investments, and are obligated to maintain comprehensive compliance programs. All of these requirements help assure that RICs do not engage in manipulative practices, become too heavily concentrated in any one investment, or create systemic risk.

Additionally, under Subchapter M of the Internal Revenue Code of 1986, at least 90% of the annual gross income of a RIC must be so-called "qualifying income" in order for the RIC to maintain its tax status as a "regulated investment company." Commodities and derivatives referencing commodities generally do not produce qualifying income under current law. As a result, some RICs use wholly-owned unregistered subsidiaries to invest in commodity derivatives transactions; each subsidiary is included within the regulatory limitations applicable to its registered parent.[59] Nevertheless, any RIC's investment in such a subsidiary, and therefore its investment in commodities or commodity-related instruments, is limited to no more than 25% of a RIC's assets under the tax diversification provisions of the Internal Revenue Code.[60]

Investment advisers to ERISA accounts are subject to strict fiduciary obligations, including the duty to discharge their duties under a stringent prudence test,[61] the duty to diversify the investment of an account's assets so as to minimize the risk of large losses[62] and the duty of loyalty, which requires each adviser to discharge its duties solely in the interest of the account and for the exclusive purpose of providing benefits to participants and beneficiaries.[63] Similarly, the Investment Company Act requires advisers to RICs and other vehicles to be registered

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[58] Section 5 of the Investment Company Act.

[59] Mutual funds utilizing this parent-subsidiary structure rely on IRS private letter rulings which conclude that income arising from a mutual fund's investment in a subsidiary that invests in commodities investments constitutes qualifying income. These same private letter rulings require such subsidiaries to comply with the requirements of Section 18(f) of the Investment Company Act and all related guidance regarding asset coverage and the use of leverage by mutual funds. *See, e.g.,* I.R.S. Priv. Ltr. Rul. 201039002 (June 22, 2010); I.R.S. Priv. Ltr. Rul. 201037012 (June 4, 2010); I.R.S. Priv. Ltr. Rul. 201030004 (Apr. 28, 2010). In addition, in various SEC No-Action Letters, the SEC has permitted RICs to establish wholly-owned foreign subsidiaries for the purpose of avoiding unfavorable foreign tax treatment or foreign investment restrictions, and has acknowledged that such subsidiaries did not avoid any regulatory requirements since the parent-subsidiary structures were operated in accordance with the Investment Company Act. *See, e.g.,* S. Asia Portfolio, SEC No-Action Letter (Mar. 12, 1997), Templeton Vietnam Opportunities Fund, Inc., SEC No-Action Letter (Sept. 10, 1996), The Spain Fund, Inc., SEC No-Action Letter (Mar. 28, 1988) and The Scandinavia Fund, Inc., SEC No-Action Letter (Nov. 24, 1986).

[60] Section 851(b)(3) of the Internal Revenue Code.

[61] ERISA § 404(A)(1)(B), 29 U.S.C.A. § 1104(A)(1)(B). This provision requires the manager to have conducted a sufficient investigation into the details and particulars of a transaction and its appropriateness for the account involved prior to engaging in a transaction.

[62] ERISA § 404(A)(1)(C), 29 U.S.C.A. § 1104(A)(1)(C).

[63] ERISA § 404(A)(1)(A), 29 U.S.C.A. § 1104(A)(1)(A).

themselves under the Investment Advisers Act of 1940, which subjects advisers to rigorous fiduciary duties of loyalty and care to customers as a matter of law.[64]

While RICs and ERISA accounts present virtually no risk of "excessive speculation" or manipulation, their unfettered participation in commodity markets provides valuable liquidity, particularly in long-dated maturities, that is beneficial to bona fide hedgers with long-term hedging needs. We therefore urge the Commission to exempt RICs and ERISA accounts from position limits, particularly where the risk of "excessive speculation" and manipulation is non-existent. Granting these exemptions would reduce the compliance cost associated with RIC and ERISA participation in commodity markets without any real reduction in the efficacy of position limits.

3.7. Grandfather relief.

3.7.1. Grandfather relief should not be limited to only those who do not increase their position after the effective date of a limit.

The Commission proposes at 150.2(f)(2) to exempt a referenced contract position ("a pre-existing position") acquired by a person in good faith prior to the effective date of a non-spot-month limit, on the condition that the position is not increased after the effective date of a limit. This latter condition should be eliminated because in many scenarios it appears to be inconsistent with the purposes of CEA sections 4a(b)(2) and 4a(c)(1).

CEA section 4a(b)(2) provides that position limits "shall not apply to a position acquired in good faith prior to the effective date of such rule, regulation, or order." CEA section 4a(c)(1) provides that "[n]o rule, regulation, or order issued under subsection (a) of this section shall apply to transactions or positions which are shown to be bona fide hedging transactions or positions as such terms shall be defined by the Commission by rule, regulation, or order consistent with the purposes of this chapter."

Consistent with these statutory directives, we believe that the Commission should exempt all pre-existing positions established in good faith from position limits, particularly those that are pre-existing bona fide hedging positions. Doing so should not undermine the Commission's ability to prevent another Amaranth or Hunt brothers.

3.7.2. The Commission should amend proposed 150.2 to provide for grandfather relief for positions that result from rolling forward of pre-existing positions.

AMG members' counterparties often hedge the risk of commodity derivatives positions by holding positions in futures contracts. In order for them to effectively hedge the risk associated with a pre-existing position, they would need to be able to roll these hedges from a prompt month into a deferred contract month. The Commission should therefore amend proposed 150.2(f)(2) to cover "any commodity derivative contract position ***<u>or position that</u>***

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[64] *See* Sections 206(1) and (2) of the Advisers Act; *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 192-93 (1963).

<u>results from transferring the price risk exposure created by such position into a deferred contract month</u> acquired in good faith…"

3.7.3. The costs associated with the Commission's narrow grandfather relief are significant.

Absent the changes we have requested above, particularly in sections 3.4.1, 3.5.1, and 3.5.2, AMG members and their customers would bear significant costs resulting from a diminished ability of AMG members to generate desired returns for customers. Without these changes, the rules as proposed would also result in diminished willingness from our counterparties to transact, resulting in unduly higher costs to enter into commodity derivatives trades. Indeed, as indicated above, AMG members witnessed a noticeable widening of the bid/ask spread, indicative of reduced liquidity, in the commodity index swaps market even before the Commission's vacated part 151 position limits rules were to take effect in 2012, which was due in part to a similarly narrow grandfather exemption under vacated 151.9.

4. *Conclusion*

As discussed above, the AMG believes that before imposing speculative position limits, the Commission must and should make fact-intensive findings of necessity and appropriateness in support of its position limits regime based on an individual contract-by-contract basis. As the Commission has failed to do so with the 2013 NPRM, we believe that it should be withdrawn. Nevertheless, if the Commission determines to proceed with this rulemaking, the Commission can better effectuate the goals of CEA section 4a by making the following changes:

- modifying the proposed spot-month limits and withdrawing or increasing the non-spot-month position limit levels;
- providing DCMs and SEFs more discretion with respect to aggregation requirements and other rules related to position limits;
- preserving the risk management exemption from speculative position limits consistent with the terms of the statute, as informed by administrative precedent and legislative history;
- granting counterparties to "commodity index contracts" an exemption for managing commodity index contract position risks;
- exempting RICs and ERISA accounts from speculative position limits; and
- expanding grandfather relief available to pre-existing positions.

* * *

The AMG thanks the CFTC for the opportunity to comment on the proposed rulemaking concerning position limits. The AMG would welcome the opportunity to further discuss our comments with you. Should you have any questions, please do not hesitate to contact Matt Nevins at 212-313-1176 or Michael Loesch at 202-662-4552.

Sincerely,

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