PIMCO

Via Electronic Submission

May 15, 2020

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

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

Dear Mr. Kirkpatrick:

This letter is submitted on behalf of Pacific Investment Management Company LLC ("PIMCO" or "we") to provide comments to the U.S. Commodity Futures Trading Commission (the "Commission" or the "CFTC") on its proposed amendments to regulations concerning speculative position limits (the "Proposal").[1] We appreciate this opportunity to share our comments with the Commission and to build on the previous comment letters that we have submitted to the Commission addressing prior position limits proposals.[2]

Introduction

PIMCO is registered as a commodity pool operator (CPO) and commodity trading advisor with the CFTC and an investment adviser with the U.S. Securities and Exchange Commission. PIMCO manages approximately $1.78 trillion in total assets[3] and approximately

1 Position Limits for Derivatives, 85 Fed. Reg. 11596 (Feb. 27, 2020) ("Proposal").

2 *See*, PIMCO Comment Letter to the CFTC, re: *Concept Release on Whether to Eliminate the Bona Fide Hedge Exemption for Certain Swap Dealers and Create a New Limited Risk Management Exemption from Speculative Limits* (May 28, 2009); PIMCO Comment Letter to the CFTC, re: *Proposed Federal Speculative Position Limits for Referenced Energy Contracts and Associated Regulations* (April 23, 2010); PIMCO Comment Letter to the CFTC, re: *Proposed Federal Speculative Position Limits for Referenced Contracts* (March 28, 2011); and PIMCO Comment Letter to the CFTC, re: *Position Limits for Derivatives: Reproposal* (February 28, 2017, the "2017 Letter").

3 Figure is as of March 31, 2020.

$518.2 billion in CPO assets[4] on behalf of millions of individuals and thousands of large institutions in the United States and globally, including state retirement plans, unions, university endowments, corporate defined contribution and defined benefit plans, and pension plans for teachers, firefighters and other government employees. Our services are provided through the management of separate client accounts, in accordance with the specific investment styles and objectives specified by the client, and through the management of mutual funds and other commingled funds that are offered to institutional and individual investors. In the case of all of these management services, we are solely engaged in the long-term investment management of our clients' assets, in accordance with the full legal duties of a fiduciary. We do not engage in proprietary trading for our own account nor directly hold client funds, nor provide balance sheet lending to our investment clients. Our principal goal is to make sound, long-term investments that will meet our clients' objectives and provide them with stable and acceptable returns that are consistent with their risk preferences over their desired time horizons. In this context, our commodity index based mutual funds allow investors to invest in a diversified basket of commodities, without affecting or intending to affect or disrupt any particular market or commodity.

PIMCO applauds the Commission for the considerable work that has gone into the Proposal and in particular, for appropriately tailoring the position limits requirements in the Proposal to target spot month trading (other than for legacy agricultural contracts), as compared to prior proposals. As a general matter, we are supportive of policies that seek to ensure that all markets and contract months have sufficient liquidity and capacity to meet the investing, risk management and hedging needs of our clients. While we generally support the current Proposal in most respects, our comments in this letter are focused on a few components of the Proposal that may result in overly broad and restrictive conditions on investment managers, and that would have an adverse impact on markets and market participants by constraining liquidity in the commodity markets, and ultimately weakening the ability of commercial market participants to use these markets for their hedging and risk management needs. Each of these points is all the more important given the recent market events and unprecedented volatility.

Comments on the Proposal

1. *PIMCO Supports the CFTC's Conclusion that Before Establishing Position Limits, It Must First Determine that the Limits are Necessary and Appropriate.*

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[4] Figure is as of December 31, 2019. Note that CPO assets include commodity interests subject to CFTC jurisdiction, as well as other pool assets.

PIMCO supports the CFTC's conclusion in the Proposal that section 4a(a)(2)(A) of the Commodity Exchange Act (the "CEA") requires that before establishing position limits, the Commission must determine that limits are necessary.[5] Specifically, the CEA provides that "excessive speculation . . . is an undue and unnecessary burden on interstate commerce," and that the CFTC "shall" adopt position limits "as the Commission finds are necessary to diminish, eliminate, or prevent such burden[.]"[6] The final rule should make clear that any position limits proposed by the CFTC should only be adopted upon a demonstration that such limits, on a commodity-by-commodity and product-by-product basis, are necessary for and appropriate to diminish the burdens on interstate commerce of excessive speculation, which the Commission must identify with sufficient particularity and supporting empirical evidence. As outlined in our previous letters on this topic, commodity position limits impose real costs and regulatory burdens on market participants, such as limiting trading, compressing liquidity and market depth, and contributing to increases in volatility. These costs will be borne by PIMCO's clients and other investors in the derivatives markets. Given these costs, and the precedential value of this specific rulemaking, the final rule should adopt a clear and definitive standard for any further expansion of position limits.

2. *Position Limits Should Not Apply to Financially Settled Futures or Swaps.*

According to the Proposal, the limits would apply separately to both physically-settled and cash-settled referenced contracts, which includes economically equivalent swaps. As explained in our previous letters on this topic, financially settled futures and economically equivalent swaps should not be subject to position limits, and their inclusion introduces unnecessary complexity into the position limits framework. As a general matter, the position limits rules should focus on issues relating to manipulation and market disruption around contract settlement and delivery. Unlike physically settled spot-month futures contracts, which are subject to price convergence with the underlying physical commodities during the delivery period, there is no practical risk of using an outsized speculative position in a financially settled futures or swap contract to "squeeze" or "corner" the underlying physical commodity market. As the Commission is aware, a financially-settled futures or swap position does not force other market participants to make or take delivery of the underlying physical commodity. Financially settled futures and swaps do not present a meaningful risk of manipulation as they settle to the pricing of the underlying referenced physical delivery futures contract. Rather, the primary impact of position limits on cash-settled commodity futures and swaps is to constrain market liquidity and depth in these instruments, increase volatility in the overall market, and necessarily increase transaction costs for commercial market participants, thus reducing their ability to hedge commercial risks, with no related benefit.

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[5] Proposal at 11603.

[6] CEA Section 4a(a)(2)(A).

3. *PIMCO Supports the Proposal's Focus on Spot Month Limits for the Additional Commodities.*

PIMCO supports the CFTC's decision to focus on spot-month limits for the sixteen newly proposed commodities in scope of the Proposal. Consistent with our prior comments on this issue, the spot month is where futures prices interact with and converge to physical commodity markets, and is the only plausible part of the futures curve where a necessity and appropriateness finding could be made. By avoiding the imposition of limits outside the spot month, the Commission will foster the formation and deepening of liquidity further out the futures curve. This will benefit participants in the futures markets immediately, and over time, will increase liquidity in correlated products and markets. For these reasons, PIMCO supports the CFTC's focus on the spot month and its decision to not impose limits outside of the spot month. If the CFTC is going to finalize limits rules, PIMCO strongly encourages the CFTC to continue to focus only on the spot months for those sixteen identified commodities.

PIMCO appreciates that the Commission understands the substantial compliance burdens that will be imposed on market participants inherently associated with the imposition of new position limits requirements. In addition to known compliance costs, we urge the Commission to consider other potential impacts to market participants, including with respect to market volatility and liquidity, as well as firms' ability to use commodity derivatives markets to hedge risks. By focusing this Proposal on spot month position limits for the core referenced futures contracts, the CFTC can help mitigate and potentially avoid certain of these costs. After the initial spot month limits have been finalized, and the Commission has been able to observe market reaction for a substantial period of time, the Commission could reconsider the additional position limits set forth in the current Proposal, and move forward only if they are actually required. By taking a more incremental approach and allowing for the benefit of observing the effects of the spot limit proposals, we believes that the CFTC can effectively manage its dual interests in robust oversight, while promoting the efficient operation of derivatives markets.

4. *The CFTC Should Ensure Parity in the Re-Calibrated Non-Spot Month Limit Levels for Wheat.*

With respect to the specific re-calibrated legacy agricultural single month and all month limits that have been proposed for wheat contracts, PIMCO urges the CFTC to ensure that these non-spot limits for Kansas City Hard Red Winter Wheat futures contracts are set at the higher level that the CFTC has proposed for the CBOT Wheat contract. Notably, the physical market for the wheat crop that is deliverable under the Kansas City Hard Red Winter Wheat contract is much larger than the wheat crop that is deliverable under the CBOT Wheat contract—

and at a minimum this supports setting consistent limit levels, if not higher levels, for the Kansas City contract as compared to the Chicago contract. In addition, the physical characteristics of Kansas City wheat is more closely analogous to the majority of the global wheat crop (for example, in protein content), as compared to the physical characteristics of wheat that is deliverable under the CBOT Wheat contract.[7] Thus, adjusting the Kansas City contract limits to reflect the higher limits that are proposed for CBOT Wheat would allow for a more effective hedge for the global wheat markets.

5. *PIMCO Supports the CFTC's Exclusion of Commodity Index Contracts.*

PIMCO agrees with the CFTC that a position in a commodity index contract should not be subject to position limits, and appreciates the CFTC's responsiveness to our prior comments on this issue. By using these financially settled derivatives products that track (rather than impact) the underlying markets, diversified commodity index investors are able to establish net-long positions in the commodity derivatives markets to either (i) hedge against broad based commodity, inflation and financial risk that naturally exists elsewhere in their portfolios or (ii) otherwise take a general view on price trends in commodity markets. These products must properly remain fully excluded from the application of any position limits rules.

6. *Risk Management Exemptions Should Continue To Be Recognized and Granted for Positions Taken to Manage Financial and Other Risks Faced by a Market Participant.*

PIMCO believes that any position limits rule that is adopted can and should include a "risk management exemption" for positions taken to manage financial and other risks faced by a market participant.

The CFTC and the exchanges have recognized risk management exemptions from positon limits for decades, without incident, and the CFTC should affirm that its positon limit rules will expressly permit market participants to use the commodity derivatives markets for valid risk management purposes. For the same reasons, the exchange risk-management exemption that is recognized in the Proposal should be available not only for excluded commodities, but should be available for all commodities. The CFTC's general position limits exemptive authority in CEA section 4a(a)(7) clearly authorizes the CFTC to continue to provide these exemptions, and PIMCO is concerned about the negative impact to markets and product availability if the CFTC elects to refuse to continue these exemptions. In particular, we are concerned that eliminating the risk management exemption will operate as a constraint on liquidity in the primary markets that will be subject to limits, with the potential to spill over into

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[7] *See* discussion of crop size and characteristic comparability to global market at: "*Kansas City vs. Chicago Wheat Spread: A Tale of Two Markets*" (Jan. 13, 2020), available at: https://www.cmegroup.com/education/articles-and-reports/kc-vs-chicago-wheat-spread-a-tale-of-two-markets.html (last accessed May 8, 2020).

related markets. From that perspective, the impact of removing the risk management exemption will be to potentially reduce the number of swap dealers that are able or willing to trade in commodity derivatives, as our counterparties lose their most efficient means of hedging the positions they enter into with us. For PIMCO and other market participants, this will increase the cost of transacting and impair our ability to continue to efficiently utilize the commodity markets.

Any withdrawal from allowing firms to rely on risk management exemptions may potentially result in disruptions to markets, counterparties, and entire lines of business. Most importantly for PIMCO, the sharpest result will be increases in costs for products such as commodity index contracts (which are often hedged by dealers of these products by using the underlying constituent futures) that would be passed on directly to PIMCO and ultimately our clients.

7. *The Commission Should Codify the Aggregation No-Action Letter.*

While the Proposal does not address the CFTC's aggregation rules, PIMCO encourages the CFTC to take the opportunity now to codify into rules the various reporting relief and interpretative guidance relevant to complying with the CFTC's aggregation rules. Specifically, PIMCO encourages the CFTC to adopt as a rule the relief in CFTC Letter 19-19, which largely extends the relief that had been granted in CFTC Letter 17-37. This relief expands the scope of entities that could rely on the independent account controller exemption and avoids the submission of numerous notice filings that would create burdens both for CFTC staff and market participants, while preserving for the CFTC the ability to make special calls to request information from market participants when needed. The aggregation relief letter, which is scheduled to expire on August 12, 2022, should be codified.

8. *The CFTC Should Adopt a Process to Annually Update and Increase Proposed Limits.*

As noted above, the Proposal would increase certain of the CFTC's existing position limits for nine legacy agricultural commodity futures contracts—PIMCO supports raising these limits and encourages the CFTC to adopt this aspect of the rule as soon as possible, even on a standalone basis. These markets have grown substantially since the last time limits were raised, and we urge the CFTC to include in any final rule a mandatory requirement to regularly (and at least annually) review and update limits as markets grow and change.

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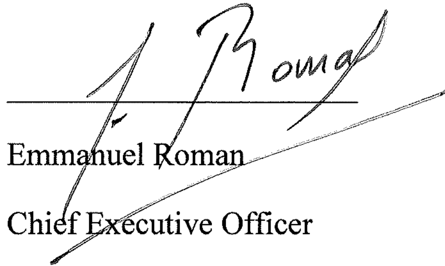
Thank you again for the opportunity to share our thoughts on the Proposal. We are at the disposal of the Commission to provide additional information or share our insights into the valuable and growing role that the commodities derivatives markets serve for our clients.

Sincerely,



Emmanuel Roman

Chief Executive Officer

cc: Chairman Heath P. Tarbert
Commissioner Brian D. Quintenz
Commissioner Rostin Behnam
Commissioner Dawn DeBerry Stump
Commissioner Dan M. Berkovitz