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July 13, 2016

Via Electronic Submission

Christopher Kirkpatrick, Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Supplemental Notice of Proposed Rulemaking ─ Position Limits for Derivatives: Certain Exemptions and Guidance (RIN 3038–AD99)

Dear Mr. Kirkpatrick:

The Futures Industry Association ("**FIA**") appreciates the opportunity to provide the Commodity Futures Trading Commission ("**Commission**" or "**CFTC**") with comments and recommendations in response to the Commission's supplemental notice of proposed rulemaking regarding exemptions from speculative position limits ("**Supplemental Proposal**").[1] FIA's regular and associate members, their affiliates, and their customers actively participate in the listed and over-the-counter ("**OTC**") derivatives markets as intermediaries, principals, and users.[2] Consequently, FIA and its members have a significant interest in the Supplemental Proposal.

I. Executive Summary

FIA supports the Commission's proposal to rely upon the expertise of the exchanges to recognize non-enumerated hedge exemptions, spread exemptions, and anticipatory hedge exemptions consistent with the Commission's guidance. FIA also supports the Commission's proposal to delay exchange-set position limits for swaps.

However, FIA believes that certain aspects of the Supplemental Proposal would inhibit the ability of exchanges to establish, or market participants to benefit from, the *bona fide* hedges that the Commission is seeking to make available. Accordingly, FIA recommends the following modifications to the Supplemental Proposal that are intended to implement the requirements of

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[1] *See Position Limits for Derivatives: Certain Exemptions and Guidance*, 81 Fed. Reg. 38458 (June 13, 2016). The proposal supplements the Commission's December 2013 proposed position limits rule. *See Position Limits for Derivatives*, 78 Fed. Reg. 75680 (Dec. 12, 2013) ("**2013 Position Limits Proposal**").

[2] FIA is the leading trade organization for the futures, options, and cleared swaps markets worldwide. FIA's membership includes clearing firms, exchanges, clearinghouses, and trading firms from more than 25 countries as well as technology vendors, lawyers, and other professionals serving the industry. FIA's mission is to support open, transparent, and competitive markets, to protect and enhance the integrity of the financial system, and to promote high standards of professional conduct. As the principal members of derivative clearinghouses worldwide, FIA's member firms play a critical role in the reduction of systemic risk in the global financial markets.

section 4a of the Commodity Exchange Act, as amended ("**CEA**") and, at the same time, to lessen the administrative burdens on market participants, the exchanges and the Commission.[3]

The Proposed Delay For Exchange Limits On Swaps

- FIA supports the Commission's proposal to delay requiring exchanges to set position limits on swaps and believes that the rationale for doing so is soundly stated in the Supplemental Proposal. FIA recommends that the Commission provide notice to the public and an opportunity to comment prior to any determination that a designated contract market ("**DCM**") or swap execution facility ("**SEF**") has access to sufficient swap position data to set exchange limits on swaps.

The Framework For Exchanges To Grant Exemptions From Federal Limits

- FIA supports the Commission's proposal to rely upon the expertise of the exchanges to administer non-enumerated hedge, spread, and anticipatory hedge exemptions from federal limits. However, FIA is concerned that the potential for Commission review of any exchange-granted exemption would create uncertainty about the status of an exemption, would not appropriately rely upon the expertise of the exchanges, and would not be an efficient use of Commission resources. Instead, the Commission should continue its existing practice of approving rules issued by exchanges governing the process for reviewing and approving applications for exemptions and, thereafter, monitoring the exchanges' administration of their rules through the Commission's rule enforcement review process.
    - Alternatively, if the Commission retains the discretion to review any exchange-granted exemption, FIA believes that it is important that the Commission's rules provide a finite period of time within which the Commission will elect to review an exchange exemption determination. The certainty provided by an outside limit on Commission review would enable market participants to apply for and rely upon substantially similar exemptions. FIA also urges the Commission to include a process for market participants to seek reconsideration of a recommendation by the Division of

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[3] FIA's comments herein supplement its prior comments regarding position limits. FIA's letter to the Commission, dated January 22, 2015, included a summary of FIA's position limit comment letters. FIA also submitted on March 30, 2015, a position limits comment letter that focused on issues discussed during the Commission's Energy and Environmental Markets Advisory Committee ("**EEMAC**") meeting on February 26, 2015. FIA incorporates its prior comments by reference and requests that the Commission consider them in conjunction with the comments herein prior to adopting a final position limits rule. Many of FIA's prior comments, including its requests that the Commission expand the number of enumerated hedges and provide a process for authorizing non-enumerated hedges, are implicated by the Commission's Supplemental Proposal. In other cases, it is unclear in the Supplemental Proposal how the Commission intends to address issues, including the conditional spot month limits and the definition of an eligible affiliate, that are important to FIA's members.

Market Oversight ("**DMO**") to overturn or modify an exchange-granted exemption.

  - Furthermore, if the Commission determines to overturn or modify an exchange-granted exemption, then the "commercially reasonable" period within which a market participant must reduce its position should take into account a number of important factors, including: (1) the size of, and risks associated with, the participant's cash and related derivative positions; (2) the risks created by the need to reduce what will become an un-hedged cash market exposure; and (3) the availability of sufficient liquidity to enable the market participant to reduce the hedging and the underlying positions without incurring losses solely as a result of being forced to liquidate the hedge within a constrained timeframe.

- The proposed conditions precedent that a contract be actively traded and that a DCM have one year of experience administering limits on the derivative contract in order to grant exemptions from federal position limits should be eliminated because they are not authorized by the CEA and would improperly preclude market participants from entering into non-enumerated *bona fide* hedges to manage the risks that they incur in the operation of their commercial businesses. In addition, these conditions would have the unintended consequence of creating anti-competitive barriers to entry for new exchanges and the listing of new Referenced Contracts on existing exchanges.

- FIA strongly supports the Commission's proposal to authorize exchanges to grant non-enumerated hedge and spread exemptions during the last five days of trading or, if shorter, the applicable spot period. The Commission has always recognized that its restriction on certain hedges during the last five days of trading is not an absolute prohibition because a market participant could apply for a non-enumerated hedge exemption depending upon the facts and circumstances related to the hedge. FIA encourages the Commission to continue this policy and authorize the exchanges to evaluate the facts and circumstances related to a participant's hedging activity in deciding whether to grant non-enumerated hedge and spread exemptions during the last five days of trading or the spot period.

- The proposed requirement that a market participant's application for a non-enumerated hedge or anticipatory hedge exemption include three years of cash market activity is not authorized by the CEA and would have the unintended effect of preventing new entrants to the relevant market. FIA believes that a better approach would be for the Commission to enable exchanges to require a market participant to provide one year of cash market activity, if available, or otherwise substantiate its eligibility for a non-enumerated or anticipatory hedge exemption to the exchange's reasonable satisfaction based upon a market participant's existing or reasonably anticipated cash market exposure.

- The Commission should clarify that an application for a non-enumerated hedge or spread exemption only must include derivative positions related to the requested exemption.

- It is important that the Commission authorize exchanges to continue to allow a market participant to apply for an exemption in advance of, or within a reasonable period after, the participant exceeds a limit.

- FIA requests that the Commission add location spreads as a common example of spread positions and make clear that the examples of permitted spread positions are not exhaustive.

- The Commission should confirm that exchanges may continue to adopt their own rules for exemptions from speculative position limits for futures contracts that are subject to DCM limits, but not to federal limits.

Proposed Reporting Requirements

- To reduce the burden on resource-constrained market participants, the Commission should streamline the reporting requirements in both the Supplemental Proposal and the 2013 Position Limits Proposal. FIA recommends that the Commission continue to authorize the exchanges to request additional information from a market participant when they deem it necessary. Similarly, if the Commission believes that it needs additional information to verify eligibility for a hedge exemption, it should utilize the special call process rather than requiring market participants to file reams of information that the Commission does not have the resources to review.

Proposed Definition Of Bona Fide Hedging Position

- The Commission should recognize that the statutory definition of a *bona fide* hedging position includes the reduction of all risks that affect the value of a cash market position, including time risk, location risk, quality risk, execution and logistics risk, credit risk, counterparty risk, default risk, weather risk, sovereign risk, and government policy risk.

- The Commission should expand the list of enumerated *bona fide* hedging positions to include, among others, anticipatory merchandising positions.

- The Commission should remove the quantitative factor and restrictions during the last five days of trading or the spot month for cross-commodity hedges because they make it unnecessarily difficult for market participants to engage in *bona fide* hedging.

- FIA supports the proposed removal of the incidental test and orderly trading requirement from the definition of *bona fide* hedge because they are unnecessary.

- The Commission should provide an exemption for, or allow market participants to net, Referenced Contracts that hedge commodity index contract exposure.

Trade Options And Position Limits

- Because trade options are a form of physical supply agreement, the Commission should confirm that trade options are not subject to speculative position limits and are eligible exposures to serve as the basis for a *bona fide* hedge.

Spot And Non-Spot Month Position Limits

- FIA urges the Commission to not impose hard non-spot month limits, and instead, consider whether it is appropriate to propose accountability levels outside the spot month.
- Spot month position limits should be based on current levels of deliverable supply.

Position Limits Implementation

- The Commission should coordinate the implementation of position limits with foreign regulators and provide market participants with at least a nine-month transition period to come into compliance with any final rule.

II. FIA Supports The Proposal To Delay Exchange Position Limits On Swaps

FIA appreciates the Commission's consideration of FIA's prior comments on this topic and supports the Commission's proposal to delay imposing a requirement for DCMs or SEFs to establish position limits on swaps.[4] As the Commission noted, "most exchanges do not have access to sufficient swap position information to effectively monitor swap position limits."[5] FIA also agrees that, "with only the transaction data from a particular exchange, it would be impracticable, if not impossible, for that exchange to monitor and enforce position limits for swaps."[6]

Because of current and potential future limitations on the ability of exchanges to access swap position information, the Commission should require notice to the public and an opportunity to comment prior to any determination that a DCM or SEF has sufficient swap

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[4] *See e.g.*, FIA Letter to CFTC, Section XI.E (Feb. 7, 2014); and FIA Letter to CFTC, Section III.C (Mar. 30, 2015).

[5] *See* Supplemental Proposal at 38460.

[6] *Id.* at 38461.

position data to establish exchange-set limits on swaps.[7] The notice should inform the public about, among other things, how the exchange obtains sufficient swap position information to enable it to monitor compliance with an exchange limit for swaps. Market participants then could evaluate the data sources available to exchanges and provide valuable comment on whether the data provide an accurate picture of a participant's position in swaps.

III. FIA Supports Authorizing The Exchanges To Approve Non-Enumerated Hedge Exemptions, Spread Exemptions, And Anticipatory Hedge Exemptions

FIA supports the Commission's proposal to authorize the exchanges to recognize non-enumerated hedging positions as eligible *bona fide* hedge exemptions.[8] This proposal more closely aligns the Commission's proposed definition of *bona fide* hedging positions with the statutory definition in CEA Section 4a(c)(2). Authorizing the exchanges to grant non-enumerated hedge exemptions leverages the expertise of the exchanges, allows commercial risk management practices to evolve over time, and conserves the Commission's resources.[9] For the same reasons, FIA supports authorizing the exchanges to grant spread exemptions and anticipatory hedge exemptions. Because the CFTC's proposed position limits apply to futures and swaps, FIA also supports allowing market participants to establish non-enumerated hedge, spread, or anticipatory hedge positions in futures and swaps.[10] As discussed in greater detail below, FIA recommends that the Commission make a number of adjustments to the Supplemental Proposal to align it more closely with the CEA and to reduce administrative burdens on market participants, the exchanges, and the Commission.[11]

A. The Commission Should Not Retain The Discretion To Review Any Exemption Granted By An Exchange

Under the Supplemental Proposal, an exchange may grant non-enumerated hedge, spread, or anticipatory hedge exemptions from federal limits, but the Commission would retain the discretion to review and potentially overturn or modify any exchange-granted exemption. FIA believes that this proposed change to the Commission's existing practice of approving and then reviewing enforcement of exchange rules is unwarranted.[12] The potential for Commission review of any exchange-granted exemption would create uncertainty about the regulatory status of an exemption, would not appropriately rely upon the expertise of the exchanges to administer hedge exemptions, and would not be an effective use of Commission resources.

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[7] *See* Supplemental Proposal Request for Comment ("**RFC**") 1 and 33.

[8] *See* Supplemental Proposal RFC 44, 45, 26, 53, and 68.

[9] *See* FIA Letter to CFTC, Section III.B (Jan. 22, 2015).

[10] *See* Supplemental Proposal RFC 6. FIA requests that the Commission confirm any information submitted to an exchange for purposes of position limits compliance that could also be sent to the Commission is subject to the Freedom of Information Act ("**FOIA**") confidentiality provisions.

[11] *See* Supplemental Proposal RFC 42 and 43.

[12] *See* ICE Futures US ("**IFUS**") Letter to CFTC (July 13, 2016) ("**IFUS 2016 Letter**") (The proposed exemption-by-exemption review process is a significant departure from longstanding practice).

FIA recommends, instead, that the Commission continue its existing practice, in which the Commission: (1) reviews and approves exchange rules governing the process for granting exemptions; and then (2) monitors the administration of exemptions by exchanges through the Commission's rule enforcement review process.[13] Continuing the existing framework would enable the exchanges to utilize their knowledge of the risks incurred by commercial enterprises and their expertise administering hedge exemptions, and would provide the Commission with time to observe the evolution and performance of exchange-granted exemptions.

1. In The Alternative, If The Commission Retains Discretion To Review Exchange-Granted Exemptions, There Should Be A Limited Time Period Within Which The Commission Will Elect To Review An Exchange-Granted Exemption

If the Commission retains discretion to review and potentially overturn or modify exchange-granted exemptions, it should limit the time period within which the Commission will conduct such a review. As proposed, the Commission has an indefinite period of time within which to elect to review an exchange's decision to grant an exemption.[14] Market participants rely upon hedge exemptions to manage the risks that they incur in operating their commercial businesses. They need regulatory certainty within a reasonable period of time that a position will remain eligible for an exemption granted by an exchange. Without certainty about the continued viability of an exemption, market participants would be unable to make long-term decisions about managing and expanding cash market businesses that incur risks that need to be hedged with Referenced Contracts. In order to provide this certainty, FIA believes it is important that the Commission limit the time period within which it would decide whether to review an exchange-granted exemption.[15]

To provide increased regulatory certainty, FIA recommends that the Commission require an exchange to post a general description of a non-enumerated hedge, spread, or anticipatory hedge exemption on its website within 30 days of granting the exemption. Thereafter, the Commission should have 180 days to decide whether to review and overturn or modify an exemption posted on an exchange's website. After expiration of the review period, absent action by the Commission to overturn or modify the exemption, the exemption should be deemed accepted by the Commission.

FIA agrees that prior to DMO recommending that the Commission overturn or modify an exemption, DMO should provide market participants that hold the exemption with an opportunity to submit a written explanation justifying the exemption. Moreover, if DMO recommends that the Commission overturn or modify an exemption because it is not consistent with CEA Section 4a(c), FIA believes it important that the Commission allow market participants to submit a written request for reconsideration of DMO's recommendation directly

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[13] *See also* IFUS 2016 Letter, Section I.

[14] *See* proposed CFTC Rules 150.9(d), 150.10(d), and 150.11(d).

[15] *See* Supplemental Proposal RFC 18.

to the Commission. Furthermore, any decision by the Commission to overturn an exchange-granted exemption should be prospective so that, if a request for reconsideration is not successful, the exemption remains in place for one year and thereafter cannot be renewed by the exchange.

FIA's recommended approach would provide a market participant with greater certainty about its ability to manage and expand its cash market business once the review period expires. In addition, it would provide other market participants with a reasonably prompt notice of an exchange-granted exemption and the ability to apply for a substantially similar exemption. Importantly, this approach would be less burdensome on the Commission than the existing process for the review of applications for non-enumerated hedges under CFTC Rule 1.47. First, the 180-day period provides the Commission with considerably more time than the 30-day review period under existing CFTC Rule 1.47. Second, the Commission would have the benefit of an exchange's prior review and analysis of the exemption.

2. If The Commission Or An Exchange Overturns Or Modifies A Previously-Granted Exemption, The Commercially Reasonable Period For A Market Participant To Reduce A Position Should Take Into Account A Number Of Important Factors

To the extent that an exchange or the Commission determines that a position in a Referenced Contract no longer qualifies for an exemption, FIA urges the Commission to clarify that a "commercially reasonable" period of time for the participant to reduce its position below a limit should reflect a number of important factors, including: (1) the size of, and risks associated with, the participant's cash and related derivative positions; (2) the risks created by the need to reduce what will become an un-hedged cash market exposure; and (3) the availability of sufficient liquidity to enable the market participant to reduce the hedging and the underlying positions without incurring losses solely as a result of being forced to liquidate the hedge within a constrained timeframe.[16] It may only take one business day to reduce a position in a highly liquid Referenced Contract, but it may take longer to reduce a position in a relatively illiquid Referenced Contract. Similarly, it may take longer to reduce a large position than a small position. A market participant may also need to reduce its cash position if it can no longer hedge the risk from the cash positions with Referenced Contracts. For all of these reasons, it is important that the Commission clarify that market participants will have reasonable flexibility when reducing positions that no longer are eligible for a hedge exemption.

B. The Commission Should Remove The Conditions Precedent That A Contract Be Actively Traded Or That An Exchange Administer Limits For At Least One Year Prior To Granting An Exemption

FIA requests that the Commission remove the proposed conditions precedent to an exchange's ability to grant non-enumerated hedge exemptions, spread exemptions, or

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[16] *See* proposed CFTC Rule 150.9(d)(4), 150.10(d)(4), and 150.11(d)(3).

anticipatory hedge exemptions that a contract be "actively traded" and that the exchange has experience administering position limits on the derivative contract for at least one year.[17] These conditions are not authorized by the CEA and impose a substantial constraint on the availability of important hedging tools for market participants. In addition, they unintentionally would create an anti-competitive barrier to entry for new exchanges or for listing new contracts on existing exchanges.

The CEA precludes the Commission from establishing limits that apply to "*bona fide* hedge positions."[18] Thus, if a hedging position meets the statutory definition of *bona fide* hedging, it cannot be subject to a speculative position limit. The statutory definition of *bona fide* hedging in CEA Section 4a(c)(2) does not include as relevant criteria whether an exchange contract is actively traded or an exchange has one year of prior experience administering limits on positions in that contract. The CEA, therefore, does not permit restricting *bona fide* hedging positions in contracts that are not actively traded or with respect to which an exchange has less than one year of experience administering limits.

Furthermore, CEA Section 4a(a)(3)(B)(iii) requires that, in setting limits, the Commission must, to the maximum extent practicable, "ensure sufficient liquidity for *bona fide* hedgers." The active trading and exchange experience requirements would reduce liquidity by precluding hedgers from fully utilizing new Referenced Contracts or Referenced Contracts on new exchanges to hedge the risks that they incur in the conduct and management of their commercial enterprises. They also may force market participants to rely upon alternative, less effective hedges.

The Commission can address any concerns that it may have about less experienced exchanges through its oversight of the exchange and its rule enforcement review process. FIA also notes that one year of experience administering position limits in a Referenced Contract is not necessarily indicative of an exchange's experience with position limits. For example, CME's New York Mercantile Exchange ("**NYMEX**") recently listed the LOOP crude oil storage futures contract (LPS) and IFUS recently listed the world cotton futures contract (WCT). Assuming for purposes of illustration that both of these futures contracts were Referenced Contracts, under the Supplemental Proposal neither NYMEX nor IFUS would be permitted to grant non-enumerated hedge, spread, or anticipatory hedge exemptions during the first year of each contract's existence notwithstanding the extensive experience of these exchanges in administering limits on positions in a variety of similar contracts.[19]

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[17] *See* Supplemental Proposal RFC 4.

[18] *See* CEA Section 4a(a)(2).

[19] Furthermore, the experience of the exchange as an institution does not necessarily correspond to the level of experience of exchange staff granting hedge exemptions. For example, an exchange can hire experienced employees or engage third-party consultants, if necessary, to administer hedge exemptions.

Finally, one of the unintended consequences of the active trading and position limit administration requirements would be anti-competitive barriers to entry for new exchanges and for existing exchanges that list new contracts.[20] In order to be viable, a new Referenced Contract listed on an existing or new exchange needs to attract liquidity, especially during its initial months of trading. If the Commission forecloses the possibility of certain *bona fide* hedge exemptions even for a one-year time period, market participants may be unable or unwilling to transact in that new contract. Consequently, the Commission's proposal would place new exchanges or an exchange that lists a new contract at an inappropriate competitive disadvantage to existing exchanges and/or existing Referenced Contracts.

IV. FIA Supports The Commission's Proposal To Authorize Exchanges To Grant Non-Enumerated Hedge Or Spread Exemptions During The Last Five Days Of Trading Or The Spot Month

The Supplemental Proposal authorizes exchanges to grant non-enumerated hedge or spread exemptions during the lesser of the last five days of trading or the time period for the spot month (the "**Five Day / Spot Period**").[21] FIA supports the Commission's proposal because it is consistent with both the statutory definition of *bona fide* hedging and sound risk management. Any prohibition on non-enumerated hedging during the Five Day / Spot Period would unduly restrict the ability of market participants to hedge the risks that are inherent in conducting and managing their commercial businesses.[22] Furthermore, a prohibition on spread exemptions during the Five Day / Spot Period could constrain the price discovery function of the futures markets.

A. The Commission Should Authorize Exchanges To Grant Non-Enumerated Hedge Exemptions During The Five Day / Spot Period

FIA supports the Commission's proposal to rely on the expertise of the exchanges to manage non-enumerated hedge exemptions during the Five Day / Spot Period. FIA requests that the Commission also make clear that an exchange can issue a non-enumerated hedge exemption for any enumerated hedge exemption that is subject to a restriction during the Five Day / Spot Period. For example, the enumerated *bona fide* hedges in proposed paragraphs (3)(iii), (4), and (5) of 150.1 do not apply during the Five Day / Spot Period. The Commission should authorize exchanges to issue a non-enumerated hedge exemption that allows a person to rely on one of these enumerated hedge exemptions during the Five Day / Spot Period. FIA recommends that the Commission include the following language in paragraph (4) and make conforming edits to paragraphs (3)(iii) and (5):

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[20] *See* Supplemental Proposal RFC 59 and RFC Antitrust Considerations.

[21] The Commission specifically requested comments regarding whether it should prohibit non-enumerated hedge or spread exemptions during the spot period. *See* Supplemental Proposal RFC 7 and 20.

[22] As IFUS similarly notes in its comment letter, the statutory definition of *bona fide* hedging does not limit hedging positions during the Five Day / Spot Period. *See* IFUS 2016 Letter, Section III.

> A *bona fide* hedging position also includes the following specific positions, provided that, unless approved by a designated contract market or swap execution facility pursuant to § 150.9, no such position is maintained in any physical-delivery commodity derivative contract during the lesser of the last five days of trading or the time period for the spot month in such physical-delivery contract.[23]

FIA's suggested rule-text is consistent with the Commission's longstanding policy for legacy agricultural position limits.[24] The Commission has long allowed market participants to apply for a non-enumerated hedge exemption during the Five Day / Spot Period if an enumerated hedge contains restrictions during that period.[25] FIA urges the Commission to continue this existing policy.

The Commission similarly should permit an exchange to grant non-enumerated hedges during the Five Day / Spot Period because the exchange understands a market participant's need to manage the risks that it incurs in operating its business. In addition, the exchange typically is in frequent communication with a market participant about how it intends to manage and liquidate its position. The exchange monitors the positions of other market participants in the particular physical-delivery Referenced Contract and knows whether sufficient liquidity is available to liquidate the hedges during the Five Day / Spot Period. An exchange also has the ability, if necessary, to reduce the size of a market participant's hedge exemption as a position in a physical-delivery Referenced Contract gets closer to delivery. Moreover, as the Commission acknowledged, the exchanges are highly motivated from a commercial and a regulatory perspective to protect the integrity of, and maintain orderly trading in, their markets.[26]

B. The Commission Should Authorize The Exchanges To Grant Spread Exemptions During The Five Day / Spot Period

The Commission also should continue to authorize the exchanges to grant spread exemptions during the Five Day / Spot Period.[27] CEA Section 4a(a)(3)(B)(iv) requires the Commission to ensure, to the maximum extent practicable, "that the price discovery function of the underlying market is not disrupted." As the Commission is aware, important price discovery occurs during the Five Day / Spot Period for physically delivered contracts. Price convergence between the physical and futures markets is a fundamental component of price discovery and risk

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[23] FIA's additional language is underscored.

[24] *See* CFTC Rule 1.3(z)(3).

[25] *See Definition of Bona Fide Hedging and Related Reporting Requirements*, 42 Fed. Reg. 42748, 42749-42750 (Aug. 24, 1977) ("In not amending the five-day rules, the Commission notes the following: […] persons wishing to exceed such limits during the five last trading days may submit materials supporting classification of the position as *bona fide* hedging pursuant to[CFTC Rule 1.3(z)(3)].").

[26] *See* Supplemental Proposal at 38465-66.

[27] *See e.g.*, CME Rule 559.C; and ICE Futures US Rule 6.29(e).

management.[28] Participation in the futures markets by commercial hedgers with the capacity to make or take delivery helps to promote price convergence. Any prohibition on holding spread positions during the Five Day / Spot Period could inhibit convergence and, in turn, the price discovery function of the futures market. Under current market practice, the exchanges review spread exemption applications and determine whether an exemption would be appropriate during the Five Day / Spot Period. Consistent with Commission's proposal to rely upon the expertise of the exchanges, the Commission should continue existing practice and allow the exchanges to determine whether a particular spread exemption should be available during the Five Day / Spot Period.

V. Hedge Exemption Applications Should Only Require Applicants To Provide One-Year Of Cash Market Activity, If Available, Or Otherwise To Substantiate The Applicant's Need For A Hedge Exemption

The proposed requirement that a market participant's application for a non-enumerated hedge or anticipatory hedge exemption include three years of cash market activity is overly burdensome, is not authorized by the CEA and would have the unintended effect of preventing new entrants to the relevant market from entering into *bona fide* hedging positions.[29] If a market participant has cash market risk that qualifies as the basis for a *bona fide* hedge, the CEA requires that the Commission recognize the Referenced Contract positions as *bona fide* hedging positions. FIA is concerned that the proposed requirement of three years of cash market data would impede new entrants to the cash market because they would not be able to hedge the risks that they incur as they enter and try to expand their business until they have three years of experience in the relevant cash market.

FIA believes that a better approach would be for the Commission to defer to the expertise of the exchanges regarding the scope of cash market information that they need in order to evaluate and grant an initial exemption application or to renew the exemption.[30] Under current exchange practice for new applications, the exchanges request one year of cash market activity. If a market participant is starting a new business and does not have one year of cash market activity, the market participant must otherwise substantiate its need for a hedge exemption to the exchange. This flexible approach ensures that exchanges have sufficient information to evaluate, grant or renew an exemption application. It also permits new entrants with less than three years of cash market activity, or well-established market participants that start a new line of business, to request a non-enumerated or anticipatory hedge exemption to hedge the risks that they incur in their businesses.

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[28] *See also* IFUS 2016 Letter, Section III.

[29] *See* proposed CFTC Rule 150.9(a)(3)(iv).

[30] FIA supports IFUS' recommendation that an application should provide such information as the relevant exchange deems necessary pursuant to its Commission-approved rules. *See* IFUS 2016 Letter, Section II.

VI. Market Participants Should Only Be Required To Include In A Non-Enumerated Hedge Or Spread Exemption Application Derivative Positions Related To The Exemption Application

The Supplemental Proposal would require a market participant applying for a non-enumerated hedge or spread exemption to include "a statement concerning the maximum size of all gross positions in *derivative contracts* to be acquired by the applicant during the year after the application is submitted."[31] FIA presumes that the Commission intends that an applicant would submit the maximum gross derivative positions related to its request for an exemption. For example, if an applicant seeks a non-enumerated exemption from the speculative position limit on WTI crude oil futures contracts, its application should include the maximum gross derivative positions in WTI crude oil. FIA assumes that the Commission does not intend that the applicant also must include, for example, its interest rate derivative positions in a WTI crude oil exemption application. FIA recommends, therefore, that the Commission clarify that an application only must include derivative positions related to an exemption application.

VII. The Commission Should Continue To Allow Market Participants To Apply For An Exemption Within A Reasonable Period After The Participant Exceeds A Limit

The Supplemental Proposal requires that a market participant apply for and obtain a non-enumerated hedge, spread, or anticipatory hedge exemption in advance of exceeding an applicable position limit.[32] This proposal is a departure from current exchange practice, which typically provides market participants with the flexibility to apply for a position limit exemption in advance of exceeding a limit or, alternatively, apply for an exemption retroactively within a specified period after exceeding a limit. FIA recommends that the Commission continue to provide market participants with the flexibility to apply for hedge exemptions either prophylactically or retroactively in compliance with exchange rules.[33]

By not providing market participants with the flexibility to apply for exemptions after exceeding a limit, the Supplemental Proposal would greatly increase the number of prophylactic and, potentially, unnecessary hedge exemption applications filed by market participants. The current approach has functioned well for many years and the Commission did not give a reasoned explanation for departing from existing practice.[34] FIA believes that the Commission should continue to afford market participants with the flexibility to seek an exemption when needed, including after exceeding a speculative position limit.

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[31] *See* proposed CFTC Rule 150.9(a)(3)(iii) and 150.10(a)(3)(iii) (emphasis added).

[32] *See* proposed CFTC Rules 150.9(a)(4)(i), 150.10(a)(4)(i), and 150.11(a)(3)(i).

[33] *See also* IFUS 2016 Letter, Section III; and CME Group Letter to CFTC ("**CME 2016 Letter**"), Section II.B.5 (July 13, 2016).

[34] FIA also notes that the existing practice for retroactive applications includes a means for addressing potential abuse. If a market participant applies for a hedge exemption after exceeding a limit, but the exchange denies the application, the market participant is in violation of the speculative position limit.

VIII. The Commission Should Add Location Spreads As A Common Example Of Spread Positions And Make Clear That The Examples Of Permitted Spread Positions Are Not Exhaustive

The Supplemental Proposal includes the following examples of common types of spread positions that may be eligible for a spread exemption: calendar spreads, quality differential spreads, processing spreads, and product or by-product differential spreads.[35] FIA recommends that the Commission add location spreads (*e.g.*, a long position at one delivery location and short position at another delivery location) as an example of a common spread position that qualifies as a *bona fide* hedging position.

FIA also requests that the Commission amend the text of proposed CFTC Rule 150.10(a)(2) to make it consistent with the language in the preamble that describes the list of common spread exemptions as "not exhaustive" and reflective of "common types of spread activity that may enhance liquidity . . . , thereby facilitating the ability of bona-fide hedgers to put on and offset positions."[36] In particular, FIA recommends that proposed CFTC Rule 150.10(a)(2) be revised as follows:

> Examples of spreads that a designated contract market or swap execution facility may approve under this section include, but are not limited to: […][37]

IX. The Commission Should Clarify That Exchanges May Continue To Adopt Their Own Rules For Exemptions For Contracts Not Subject To Federal Speculative Position Limits

For futures contracts that are not Referenced Contracts but are subject to DCM position limits, proposed CFTC Rule 150.5(b)(5) provides that DCM rules for exemptions from DCM limits must "*conform* to the definition of bona fide hedging position in § 150.1 or provide for recognition as a non-enumerated bona fide hedge *in a manner consistent with* the process described in § 150.9(a)" (emphasis added). The Supplemental Proposal did not explain why the DCMs must follow the Commission's definition of *bona fide* hedging or administer non-enumerated hedging in a manner consistent with the Supplemental Proposal for futures contracts that are not Referenced Contracts.[38]

The proposal to apply the Commission's *bona fide* hedging definition or administer non-enumerated hedging consistent with the Supplemental Proposal for all futures contracts that are not Referenced Contracts greatly expands the impact of the Supplemental Proposal. FIA submits

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[35] *See* Proposed 150.10(a)(2)(i)-(iv).

[36] *See* Supplemental Proposal at 38478. FIA also notes that the proposed definition of intermarket and intramarket spread positions in proposed CFTC Rule 150.1 does not include an exhaustive list of position types.

[37] FIA's additional language is underscored.

[38] *See also* CME 2016 Letter, Section II.C; and IFUS 2016 Letter, Section I.

that the Commission should authorize the DCMs to adopt, or continue to utilize, DCM rules for exemptions from the DCM position limits. The Supplemental Proposal makes clear that DCMs have the experience and expertise to manage the position limit exemption process. For non-Referenced Contracts, the Commission should continue to rely on the expertise of the exchanges to manage their limits and adopt rules that provide exemptions consistent with the CEA.

FIA also notes the CEA Section 4a(c)(2) does not authorize the Commission to define *bona fide* hedging for all contracts. Rather, the definition of hedging only applies to limits established pursuant to CEA Section 4a(a)(2). As the Commission is aware, the limits proposed under CEA Section 4a(a)(2) relate to Referenced Contracts and not non-Referenced Contracts. Furthermore, 4a(a)(2) does not apply to excluded commodities. As a result, CEA Section 4a(c)(2) does not apply to non-Referenced Contracts for which the Commission has not proposed federal limits.[39]

X. FIA Recommends That The Commission Streamline The Extensive Proposed Reporting Requirements

The reporting requirements in the Supplemental Proposal and in the 2013 Position Limits Proposal would impose substantial burdens on market participants, but would provide only limited surveillance benefits. FIA submits that there are other ways for the exchanges and the Commission to obtain substantially the same data that would be supplied in the proposed forms and that would decrease the costs incurred by market participants, the exchanges and the Commission to manage and analyze position information. FIA recommends that the Commission streamline the reporting requirements and authorize the exchanges to request additional information from a market participant if and as needed. Similarly, the Commission should request any additional information that it needs via a special call.

A. The Commission Should Eliminate The Requirement That Market Participants Must Track And Report To An Exchange Non-Enumerated, Spread, And Anticipatory Hedge Positions

FIA recommends that the Commission remove the proposed requirement that an exchange must adopt enhanced reporting rules for market participants that rely on non-enumerated hedge exemptions, spread exemptions, or anticipatory exemptions.[40] The Supplemental Proposal would force exchanges to establish rules that require market participants to report all Referenced Contract positions that they hold or control in reliance upon a non-enumerated hedge, spread, or anticipatory hedge exemption along with the underlying cash market exposure (*e.g.*, cash positions or components of a spread) hedged by those positions. The

[39] If, notwithstanding FIA's comments to the contrary, the Commission decides to require exchanges to apply the exemption process in proposed CFTC Rule 150.5 to non-Referenced Contracts, then all of FIA's comments concerning the process for Referenced Contracts apply equally to non-Referenced Contracts.

[40] *See* proposed CFTC Rule 150.9(a)(6), 150.10(a)(6), and 150.11(a)(5). *See also* Supplemental Proposal RFC 17.

exchanges also would have to establish rules requiring market participants to keep these reports up to date.

As FIA has commented previously, most market participants hedge risk on a portfolio basis and generally have no business reason to distinguish between different types of *bona fide* hedging transactions. If the Commission requires exchanges to adopt enhanced reporting requirements, a market participant would need to implement significant changes to its business practices in order separately to report its non-enumerated and anticipatory hedging activity. Because positions taken in reliance upon both enumerated and non-enumerated hedge exemptions granted by an exchange would constitute *bona fide* hedging positions, the Commission should not impose enhanced reporting rules for non-enumerated hedging positions.

The costs associated with the proposed enhanced reporting rules would be substantial. First, market participants would need to modify their current business practices and information-technology systems in order separately to identify non-enumerated hedging and associated cash positions. For some participants, developing a uniform reporting system may be even more challenging because different systems track positions in different asset classes. Second, in order to keep the information in their reports to exchanges up-to-date, market participants effectively may have to report underlying exemption-eligible positions (*e.g.*, the quantity of crude oil in a tank for storage that justifies a storage hedge) on a daily basis depending upon how frequently those positions change.

FIA notes that a market participant already would have provided the exchange (who, in turn, would provide the Commission), with information about the nature of the participant's cash market activity and the size of its cash market exposure when it applies for an exemption. As a result, the costs associated with the proposed enhanced reporting do not appear to provide any discernible benefit.[41] If an exchange or the Commission has questions about a market participant's reliance on a particular exemption, the exchange or the Commission has the ability to request additional information from the participant.[42] Access to that information provides both the exchange and the Commission with the tools that they need to monitor ongoing compliance with non-enumerated hedge exemptions, spread exemptions, and anticipatory exemptions.

B. The Commission Should Eliminate The Reporting Forms In The 2013 Proposed Rule And Instead Rely On The Exchanges To Collect Cash Market Information That Justifies An Exemption

The Supplemental Proposal did not eliminate the plethora of proposed forms that market participants must file with the Commission. The 2013 Position Limits Proposal included four position limits forms: Form 204 for *bona fide* hedging, Form 504 for the conditional limit, Form

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[41] FIA agrees with CME Group that the enhanced reporting requirements would inundate the exchanges with reports that provide limited value. See CME 2016 Letter, Section II.B.3. *See* Supplemental Proposal RFC 67.

[42] *See also* IFUS 2016 Letter, Section II; and CME 2016 Letter, Section II.B.3.

604 for certain pass-through swaps, and Form 704 for anticipatory hedging. The exchange application requirements for the non-enumerated hedge, spread, and anticipatory hedge exemptions are in addition to the previously proposed forms. In total, these filing requirements are extensive and impose tremendous compliance burdens on market participants when simpler, less burdensome alternatives exist.[43]

The Commission previously stated that it plans to use the proposed position limit forms to monitor whether a person's underlying cash position justifies a Referenced Contract position in excess of an applicable speculative position limit.[44] Because a market participant would complete the proposed forms as of the last Friday of the month, the CFTC would need to issue a special call to obtain information about a market participant's cash position underlying a hedging position for any other day of the month. As a result, the forms only provide the Commission with a limited surveillance benefit. However, as FIA has commented in the past, the forms impose a substantial and costly regulatory burden on commercial hedgers.[45]

One alternative to the proposed forms would be to require that, if a market participant intends to exceed a federal limit, the participant must file a notice (renewed annually) with an exchange detailing its maximum cash market exposure that justifies an exemption.[46] For example, if the limit is 100, and a participant holds 90 long OTC positions and 50 long positions on a DCM, the participant would need to submit a notice to the DCM. The exchange would then provide the Commission with the notice filing supporting the participant's exemption. This approach, in lieu of the various Commission forms, provides the following benefits:

- Market participants can develop processes and report *bona fide* hedging information to the exchange as opposed to having to develop separate processes for submitting post-exemption reports to the exchange and the Commission. If a participant needs to apply to an exchange for an exemption, such as a non-enumerated hedge exemption, the participant could coordinate the notice filing with the application to the exchange.

- The Commission would receive *bona fide* hedging and other exemption information from all market participants that exceed an applicable federal position limit. The Commission could use the information provided by the exchange to determine the maximum size of a participant's position that is eligible for an exemption. Furthermore, because the 2013 Position Limits Proposal and the Supplemental Proposal already require that a market participant maintain records sufficient to demonstrate eligibility for a position limits exemption, the Commission can issue a special call to confirm exemption eligibility for a particular day.

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[43] *See* FIA Letter to CFTC, Section IX (Feb. 7, 2014).

[44] *See* 2013 Position Limits Proposal at 75741.

[45] *See* FIA Letter to CFTC, Section IX (Feb. 7, 2014).

[46] The participant could supplement the filing throughout the year, if necessary.

- The process for the Commission to monitor position limit compliance under FIA's suggested alternative would be substantially similar to the process under the Commission's proposed forms. In both instances, the Commission (or an exchange) would know the maximum size of a participant's position that is eligible for an exemption. The Commission (or an exchange) could verify compliance on a particular day through the issuance of a special call to confirm that a participant's underlying exemption-eligible cash market exposure supported a Referenced Contract position in excess of a limit on a particular day.

- The main differences between FIA's alternative and the Commission's proposed forms are the extent of the reporting obligations for market participants and the amount of data that the Commission would have to manage and potentially review. Under FIA's alternative, market participants file a notice with an exchange and maintain records confirming eligibility for an exemption. In contrast, under the proposed forms, market participants must file monthly and sometimes daily reports to the Commission and maintain records confirming eligibility for an exemption.

C. The Commission Should Not Adopt Enhanced Reporting Requirements Related To Exemptions During The Five Day / Spot Period

Although the Supplemental Proposal did not include enhanced reporting requirements if a participant relies on a non-enumerated hedge, spread, or anticipatory hedge exemption during the Five Day / Spot Period, the Commission requested comment about whether enhanced reporting would be appropriate.[47] For example, obligating market participants to report the Form 504 describing the participant's cash each day of the Five Day / Spot Period. FIA respectfully submits that additional reporting requirements are unnecessary and would impose costs on market participants that would exceed any benefit to the exchanges or the Commission.

Imposing an obligation to submit daily reports of cash positions during the Five Day / Spot Period for a particular contract does not provide the Commission with appropriate information to monitor hedging activity. For example, in the energy markets, participants often trade during the spot period to hedge deliveries due the following month. The spot period for the NYMEX WTI July futures contract is the last three trading days in June. If a person holds a hedge exemption during the spot period, it is unclear how daily reporting of cash positions that are unrelated to the exemption, such as daily inventory, helps Commission Staff monitor whether the person's cash position supports an exemption.

As FIA has commented previously, daily reporting requirements do not provide market participants with sufficient time to ensure the accuracy of reports that they must submit to exchanges or the Commission.[48] Based upon existing cash market practices, market participants do not necessarily have real-time data that precisely measures their current cash market exposure

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[47] *See* Supplemental Proposal RFC 8, 9, 21, and 22.

[48] *See* FIA Letter to CFTC, Section X (Feb. 7, 2014).

and, therefore, would need to estimate their daily cash positions. For example, in the crude oil market, a market participant must nominate a quantity for delivery in advance of the monthly delivery period extends. Using the June delivery period as an example, a nomination to move crude oil from one terminal to another is due on May 25. Although the delivery of crude oil takes place during the month of June, the seller will not know the exact quantity delivered and on which days during the month until it receives an account statement the following month in July. This makes it impossible for a seller (or a buyer) to report the exact crude oil in inventory on a daily basis in June. Similar measurement challenges exist in the cash market for refined products such as RBOB and heating oil. For example, volumes are estimated on a schedule when in transit. Although inventories are monitored daily, the inventories are not considered final until after the end of the month. Finally, as the Commission is well aware, many physical commodity contracts have delivery tolerances of plus or minus 5 percent, so the exact quantity delivered may vary.[49]

Because of the foregoing practical challenges, daily reporting of cash market positions would impose significant costs on market participants and would not provide the Commission with an accurate, real-time picture of a market participant's cash market exposure.[50] Market participants would need to develop automated systems to estimate quantities, in some cases, across multiple regions of the world that account for delivery discrepancies, shrinkage, loss, decline in quality, and degradation, among other factors. In addition, market participants would need to adjust their existing accounting systems, which typically are updated monthly, to a daily system for which there is no business purpose. Thereafter, market participants would need to process their estimates into a format consistent with the Commission's one-size-fits-all form.[51] Rather than impose these significant expenses for the limited regulatory benefit, the Commission or the exchange should request the information from a market participant on an as-needed basis.

Because of the practical difficulties associated with compiling contemporaneously comprehensive and accurate daily reports, if the Commission imposes daily reporting requirements, the rules should include a safe harbor for discrepancies and good faith mistakes that fall within commercially reasonable tolerance levels.[52] Furthermore, daily reporting requirements should not distinguish between various periods within the spot month. Market participants' systems are currently designed to track the spot month position limits, but may not

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[49] *See Statutory Interpretation Concerning Forward Transactions*, 55 Fed. Reg. 39188, 39189 (Sept. 25, 1990).

[50] *See also* CME 2016 Letter, Section II.B.3 (The Commission did not explain why it needs access to real-time, continuous exposure data reports).

[51] To the extent that the Commission intends to adopt a daily reporting form for non-enumerated, spread, or anticipatory exemptions, the Commission should publish the form for public comment to allow FIA to provide comments regarding the anticipated costs and evaluate any potential impact from an accounting perspective.

[52] As the Commission is aware, the Commission Staff currently view inaccurate reports as a strict liability offense. *See* CFTC Staff Letter 13-42, Division of Market Oversight Advisory: Obligation of Reportable Market Participants to File CFTC Form 204 Reports, Comm. Fut. L. Rep. ¶ 32,671 (July 8, 2013) ("Failure to file Form 204 reports in a timely manner and follow instructions constitutes a violation of Regulation 19.01, which is actionable under the Commodity Exchange Act ("CEA") and Commission regulations.").

distinguish between the spot month and the last five days of trading. Therefore, it would be commercially impracticable for any reporting requirements to be based upon a subset of the spot month.

XI. The CEA's Definition Of *Bona Fide* Hedging Position Recognizes The Reduction Of Many Risks That Affect The Change In Value Of A Cash Market Position

CEA Section 4a(c)(2)(A)(ii) requires that a *bona fide* hedge be "economically appropriate to the reduction of *risks* in the conduct and management of a commercial enterprise" (emphasis added). The Commission should read the term "risks" in the economically appropriate test to encompass more than just price risk.[53] As other commenters have pointed out, commercial market participants face numerous risks in the conduct of a commercial enterprise, including time risk, location risk, quality risk, execution and logistics risk, credit risk, counterparty risk, default risk, weather risk, sovereign risk, and government policy risk.[54]

The reference to the plural "risks" in CEA Section 4a(c)(2)(A)(ii) means that transactions that are economically appropriate to the reduction of more than a single type of risk qualify as *bona fide* hedging transactions.[55] The hedging of the above-referenced risks also is consistent with the requirement that a *bona fide* hedge "arises from the potential change in value of [certain underlying or anticipated assets, liabilities, or services]."[56] FIA agrees with the examples previously provided by the CMC that describe how additional risks affect the value of a cash market position.[57] FIA requests that the Commission determine that a hedging transaction related to the above-referenced risks qualifies as a *bona fide* hedge where the transaction arises

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[53] *See* Supplemental Proposal RFC 35.

[54] Commodity Markets Council ("**CMC**") Letter to CFTC (Mar. 28, 2015). *See also* Morgan Stanley Letter to CFTC at 20-22 (Feb. 10, 2014) (Discussion of the management of credit risk that arises through the credit valuation adjustment process and the use of commodity positions to hedge such risks).

[55] The Commission has adopted a similar methodology to interpret whether other sections of the CEA refer to singular or plural topics. For example, in the Protection of Cleared Swaps Customer Contracts and Collateral rulemaking, the Commission interpreted CEA § 4d(f)(2), which requires a futures commission merchant ("**FCM**") to treat all property of any swaps customer as belonging to the swaps customer, to mean that FCMs and derivatives clearing organizations ("**DCOs**") must segregate each individual customer's funds. *See Protection of Cleared Swaps Customer Contracts and Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions*, 76 Fed. Reg. 33818 (June 9, 2011). The Commission explained that: "the use of 'customer' in the singular contrasts with section 4d(b) of the CEA, which governs the handling of customer collateral by DCOs in the futures market. Section 4d(b) prohibits a DCO from holding, disposing, or using customer collateral 'for deposit in a separate account […] as belonging to […] any person other than the customers of such futures commission merchant,' ***using the plural form 'customers' to refer to the property of customers collectively***." *Id.* at 33825 (emphasis added).

[56] CEA § 4a(c)(2)(A)(iii); *see also* CMC Letter to CFTC (Mar. 28, 2015).

[57] CMC Letter to CFTC (Jan. 22, 2015) (*e.g.*, a grain elevator hedging unfixed priced purchases and anticipated sales in order to hedge the timing difference between the purchase and eventual sale); *see also* CMC Letter to CFTC (Feb. 10, 2014).

from the potential change in value of the underlying or anticipated assets, liabilities or services described in the CEA.

XII. The Commission Should Expand The List Of Enumerated Hedging Positions

The Supplemental Proposal did not expand the list of enumerated *bona fide* hedging positions. FIA requests that the Commission consider FIA's prior comments recommending that the Commission expand the list of enumerated hedges to include the examples in the petition submitted by the Working Group of Commercial Energy Firms ("**Working Group Petition**").[58] In particular, the list of enumerated hedges should include, among others, anticipatory merchandising transactions because the CEA expressly includes anticipatory merchandising transactions as a basis for a *bona fide* hedge.[59] The statutory definition reflects Congressional intent that hedges of anticipatory merchandising transactions should not be subject to federal position limits.[60]

To the extent that the Commission does not expand the list of enumerated hedges to include the examples in the Working Group Petition, the Commission should confirm that each of the examples may qualify as a non-enumerated hedging position depending upon the facts and circumstances applicable to the cash market exposure for which the non-enumerated hedging exemption is sought.[61]

XIII. The Cross-Commodity Hedging Provisions Make It Unnecessarily Difficult For Market Participants To Hedge Risk

A. The Commission Should Remove The Proposed Quantitative Factor

FIA notes that the Supplemental Proposal did not address from the 2013 Position Limits Proposal the quantitative factor for determining whether a cross-commodity hedge qualifies as a *bona fide* hedge. That test imposes an unnecessarily rigid correlation requirement between the daily spot price series for the target commodity and the price series for the commodity underlying the derivative contract (or the price series for the derivative contract used to offset risk) of not less than 0.80 for a period of at least 36 months. If a cross-commodity hedge does not meet the quantitative factor, it does not qualify as a *bona fide* hedge, and a market participant must apply to the Commission to recognize the cross-hedge as a *bona fide* hedge. FIA reiterates its prior comment that the Commission should remove the quantitative factor because it represents an overly narrow standard for cross-commodity hedging that is inconsistent with long-

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[58] *See* FIA Letter to CFTC, Section IX.E (Feb. 7, 2014).

[59] CEA Section 4a(c)(2)(A)(iii) defines *bona fide* hedging to include hedging "assets that a person owns, produces, manufactures, processes, or *merchandises*, or *anticipates* owning, producing , manufacturing, processing, or *merchandising*."

[60] *See also* IFUS 2016 Letter, Section III.

[61] *See also* CME 2016 Letter, Section II.B.1 (The Commission should provide the exchanges with the discretion to recognize a strategy that is not an enumerated hedge as a non-enumerated *bona fide* hedge).

standing and widely-accepted commercial practices and presents substantial administrative burdens for market participants and the Commission.[62]

B. The Commission Should Remove The Restriction On Cross-Commodity Hedging During The Five Day / Spot Period

The Supplemental Proposal did not address the restriction in the 2013 Position Limits Proposal that a cross-hedging position in a physical-delivery Referenced Contract does not qualify as a *bona fide* hedge during the Five Day / Spot Period. FIA reiterates its prior comment that the Commission should remove the restriction on cross-commodity hedging during the Five Day / Spot Period because it prevents market participants from hedging risk. For example, a jet fuel supplier may need to hedge fixed-price sales of jet fuel with the NYMEX Light Sweet Crude Oil (CL) or Heating Oil (HO) futures contracts because there is no jet fuel futures contract and may need to keep the hedge in place into the spot period (*i.e.*, the last three days of trading) in order to protect itself against price changes during that period. Moreover, the Commission should permit cross-commodity hedges held into the Five Day / Spot Period to qualify as a *bona fide* hedge where an energy futures contract is permitted to be liquidated through an exchange-for-physical ("**EFP**") process following contract expiry and the commodity underlying the physical leg of the EFP is related but not identical to the commodity underlying the futures leg of the EFP.

When the Commission originally adopted the restrictions to *bona fide* hedging during the last five days of trading, it based its decision on hedging practices in the agricultural markets in the 1970s.[63] Putting aside whether the Commission's determination in the 1970s was correct, there are material differences between the conduct and management of commercial enterprises in the agricultural markets as they existed in the 1970s and conduct and management of commercial enterprises in the energy, metals and even the agricultural markets today. These differences include, among others, the existence of many new Referenced Contracts, the development of broader and more diverse cash commodity markets, and newer and more innovative hedging strategies.

Given the differences between agricultural and metals markets and the energy markets, the changes in the cash markets since the 1970s, and the new statutory definition of *bona fide* hedging, FIA urges the Commission to reconsider its restrictions on *bona fide* hedging in the Five Day / Spot Period.[64] Alternatively, as noted above and consistent with current exchange

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[62] *See* FIA Letter to CFTC, Section IX.C (Feb. 7, 2014). *See also* IFUS 2016 Letter, Section IV.

[63] *See Definition of Bona Fide Hedging and Related Reporting Requirements*, 42 Fed. Reg. 42748, 42719 (Aug. 24, 1977) (Suggesting that there was less commercial need for anticipatory and cross-hedges in the agricultural markets at that time).

[64] One significant difference between most agricultural futures contracts and most energy futures contracts demonstrates the inappropriateness of applying the five day rule to the latter. Unlike the futures contracts for agricultural and metals commodities, which trade up to and through the delivery month, most energy futures contracts trade up to but not through the delivery month. Consequently, price convergence typically occurs later in

and Commission practice, the Commission should confirm that market participants can apply to an exchange for a non-enumerated hedge exemption if an enumerated hedge restricts the exemption during the Five Day / Spot Period.[65]

XIV. FIA Supports Removal Of The Incidental And Orderly Trading Requirements From The Definition Of *Bona Fide* Hedging Position

FIA supports the Commission's proposal to delete the incidental and the orderly trading requirements from the definition of a *bona fide* hedging position. Neither of these requirements is part of the statutory definition of a *bona fide* hedging position, so there is no basis for including them as limitations on permitted *bona fide* hedging positions.[66] FIA also agrees that the Commission should address concerns about disruptive trading through its disruptive trading practices and anti-manipulation authority, rather than through the proposed position limits rule.

XV. The Commission Should Provide An Exemption For, Or Allow Market Participants To Net, Referenced Contracts That Hedge Commodity Index Contracts

The Supplemental Proposal specifically prohibits exchanges from granting spread exemptions to market participants with commodity index exposure.[67] As FIA has commented previously, the position limits rule should not preclude market participants from hedging commodity index exposure or should permit market participants to net commodity index contracts with Referenced Contracts.[68] The CEA only authorizes the Commission to establish position limits, as necessary, to prevent excessive speculation. Positions that hedge commodity index exposure with Referenced Contracts are hedging quantifiable market risk, and it is not appropriate to characterize them as "speculative." Therefore, Referenced Contracts that hedge commodity index exposure should not be subject to a speculative position limit.

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the process for energy commodities than for agricultural or metal commodities. There is thus a corresponding need to maintain a hedge further into the spot month. For many energy futures contracts, exchanges permit EFP-only sessions following the settlement on the last day of trading and in order to participate in these EFP markets, market participants need to carry their futures positions through the spot month. Application of the five day rule to trading energy commodities into the spot month might cause market participants to remove the hedge of their physical commodity or use less effective instruments to hedge their price risks in the spot month and into the EFP sessions. Such actions might reduce liquidity in the most relevant futures contract, impair price discovery, and increase costs to commercial energy firms. Thus for physically-settled energy contracts for which trading takes place up to but not through the delivery month, *bona fide* hedging should be permitted up to and through the end of the EFP-only session so that market participants can realize the benefit of price convergence on their hedges.

[65] *Supra* Section IV.

[66] *See* Supplemental Proposal RFC 34 and 36.

[67] *See* proposed CFTC Rule 150.10(a)(1)(ii); and Supplemental Proposal at 38509.

[68] *See* FIA Letter to CFTC, Section VI (Feb. 7, 2014).

Indeed, the Commission's Office of the Chief Economist ("**OCE**") appears to support FIA's view that positions which hedge financial exposure are not speculative positions.[69] The OCE acknowledged that evaluating trade data that categorizes market participants as "commercial" and "non-commercial" is an incomplete measure for identifying excessive speculation because "commercials may speculate and non-commercials may well hedge."[70] Non-commercials that hedge are not speculating and, therefore, do not contribute to excessive speculation. One example of hedging that the OCE provides is a hedge fund that hedges "their stock portfolio by diversifying with commodity futures, based on their belief that there is generally a relative low correlation between equity and commodity price returns or that commodity futures provide a hedge against inflation or fixed income risk."[71] In light of the fact that hedging commodity index exposure cannot be accurately characterized as "speculative," the Commission should not limit this activity because it does not contribute to excessive speculation.

The Commission's position limits rule should allow market participants to net commodity index contracts with Referenced Contracts.[72] When a market participant hedges commodity index exposure, the participant's position is net flat. Neither the 2013 Position Limits Proposal nor the Supplemental Proposal explain why a flat position should be subject to a position limit. Furthermore, the CFTC's netting rules create an arbitrary distinction between Referenced Contracts and commodity index contracts. As noted above, Referenced Contract positions do not net with exposure from commodity index contracts. Yet if a market participant held the same exposure as a commodity index contract in the form of several individual swaps, the participant's Referenced Contract hedges would net to zero. FIA submits that it is arbitrary and capricious for the Commission's netting rules to distinguish between (1) a single swap with multiple components, which would not net against Referenced Contracts, and (2) the same exposure comprised of multiple swaps, which would net against Referenced Contracts.

XVI. The Commission Should Confirm That Trade Options Are Not Subject To Position Limits And Eligible To Serve As The Basis For A *Bona Fide* Hedge

FIA agrees with the Commission's recent determination in its trade option rule that "federal speculative position limits should not apply to trade options."[73] Unlike financially-settled swaps, trade options are a form of physical supply agreement that, when exercised, require physical settlement.[74] To the extent these physical supply agreements incur risk in a similar manner to forward contracts, the Commission should allow market participants to utilize

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[69] 162 Cong. Rec. E1005-07 (daily ed. June 28, 2016) (statement of Rep. Conaway) available at http://agriculture.house.gov/uploadedfiles/position_limits_analysis.pdf.

[70] *Id.* at 8-9.

[71] *Id.* at 9.

[72] *See also* IFUS 2016 Letter, Section IV.

[73] *See Trade Options*, 81 Fed. Reg. 14971 (Mar. 21, 2016).

[74] *See* CFTC Rule 32.3(a)(3).

Referenced Contracts to hedge that risk.[75] Therefore, trade options should be eligible to serve as the basis for a *bona fide* hedging position.

XVII. The Commission Should Not Impose Hard Non-Spot Month Limits, And Instead, Consider Whether It Is Appropriate To Propose Accountability Levels Outside The Spot Month

As FIA has commented previously, the Commission should withdraw the proposed hard non-spot month limits, and address non-spot month positions as part of a later and separate rulemaking.[76] In anticipation of such a separate rulemaking proposal, the Commission could study whether accountability levels are a more appropriate form of limit outside the spot month.

FIA previously explained the Commission's statutory authority to impose accountability levels outside the spot month as a form of position limits.[77] Similar to the Supplemental Proposal, the Commission also should rely upon the expertise of the exchanges to help administer accountability levels to conserve Commission resources.[78] For example, the DCMs could administer accountability levels in their own markets and rely upon the Commission to notify the DCM when a market participant's aggregate position exceeds an accountability level.[79]

Should the Commission nevertheless move forward with non-spot month position limits, the CFTC should use open interest data for all referenced contracts. The Commission states in the Supplemental Proposal that it plans to include its Part 20 swaps large trader reporting data for the open interest calculation to set initial levels for non-spot month position limits.[80] As the Commission is aware, Part 20 swap reporting represents a limited subset of swap open interest because Part 20 only includes physical commodity swaps that involve a swap dealer or clearing member. FIA urges the Commission to rely on the broader swap data reported to the swap data repository in order to consider the full scope of swap open interest for referenced contracts.

XVIII. Spot Month Limits Should Be Based Upon Current Estimates Of Deliverable Supply

In order to calculate spot month limits as a percentage of deliverable supply, the Commission must establish current levels of deliverable supply. Consistent with its prior comments, FIA submits that the 2013 Position Limits Proposal relies upon outdated estimates for deliverable supply.[81] FIA understands that CME recently submitted updated deliverable supply

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[75] *See also* IFUS 2016 Letter, Section IV.

[76] *See* FIA Comment Letter, Section II (Mar. 30, 2015). *See also* IFUS 2016 Letter, Section IV.

[77] *See* FIA Comment Letter, Section III.A (Mar. 30, 2015).

[78] *See* FIA Comment Letter, Section III.B (Mar. 30, 2015).

[79] *Id.*

[80] Supplemental Proposal at 38459.

[81] *See* FIA Letter to CFTC, Section IV.A (Feb. 7, 2014).

estimates for various commodities. FIA urges the Commission to incorporate these updated deliverable supply estimates into its calculation of spot month position limits.[82]

XIX. The Commission Should Coordinate The Implementation Of Position Limits With Foreign Regulators And Provide Market Participants With At Least A Nine-Month Transition Period To Comply With A Final Rule

FIA renews its prior comment that the Commission should coordinate its implementation of position limits with foreign regulators.[83] Furthermore, if and when the Commission issues a final position limits rule, the Commission should provide market participants with a transition period of at least nine months.[84] Because the Supplemental Proposal contemplates the exchanges adopting rules related to position limits, the nine-month compliance period should not commence until the exchanges' implementing rules are final. Market participants need time to develop, test and implement systems to come into compliance. Furthermore, registrants such as swap dealers will need to draft and implement policies and procedures reasonably designed to prevent violations of position limits.

XX. Conclusion

For the reasons explained above, FIA requests that the Commission incorporate FIA's comments and recommendations in the final position limits rule. Please contact Allison Lurton, Senior Vice President and General Counsel, at 202-466-5460, if you have any questions about FIA's comments or recommendations.

Respectfully submitted,

Walt L. Lukken
President and Chief Executive Officer

cc: Honorable Timothy G. Massad, Chairman
Honorable Sharon Bowen, Commissioner
Honorable J. Christopher Giancarlo, Commissioner
Vincent A. McGonagle, Director
Stephen Sherrod, Senior Economist
Riva Spear Adriance, Senior Special Counsel
Lee Ann Duffy, Assistant General Counsel
Steven Benton, Economist

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82 *See also* IFUS 2016 Letter, Section IV.

83 *See* FIA Letter to CFTC, Section II (Jan. 22, 2015).

84 *See* FIA Letter to CFTC, Section II (Jan. 22, 2015); and FIA Letter to CFTC, Section XIII (Feb. 7, 2014).