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February 7, 2014

Via Electronic Submission

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

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

Dear Ms. Jurgens:

The Futures Industry Association ("FIA") appreciates the opportunity to provide the Commodity Futures Trading Commission ("Commission" or "CFTC") with the comments and recommendations set forth below in response to the Commission's Notice of Proposed Rulemaking concerning *Position Limits for Derivatives*, 78 Fed. Reg. 75680 (Dec. 12, 2013) ("Proposed Rule"). FIA's comments and recommendations focus on the impact of speculative position limits on the public policy imperatives of protecting the price discovery and risk-management functions of liquid and fair derivatives markets. Due to the interrelated nature of several aspects of the proposed position limits and aggregation rules, FIA requests that the Commission consider and address FIA's comments on both proposals together when finalizing these two rulemakings.

I. Interest of FIA in the Commission's Proposed Speculative Position Limits

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.[1] For this reason, FIA has participated in all aspects of the Commission's speculative position limits rulemaking process, including the Part 151 proposed rule,[2] the Part

1 FIA is the leading trade organization for the futures, options, and OTC cleared derivatives markets. FIA members are active users of the commodity futures markets and include derivatives clearing firms of all sizes as well as leading derivatives exchanges and large commodity firms. Given the variety of enterprises that comprise our regular and associate members, FIA is the only association representative of all organizations that have an interest in the cleared derivatives markets.

2 *See Position Limits for Derivatives*, 76 Fed. Reg. 4752 (Jan. 26, 2011) ("2011 Proposed Rule"); *see also* Letter from FIA, to Commodity Futures Trading Comm'n (Mar. 25, 2011) ("FIA March 2011 Letter"), *available at* http://www.futuresindustry.org/downloads/FIA_Position_Limits_Comment_Letter.pdf; Letter from FIA, to

151 interim final rule,[3] the proposed amendments to the aggregation requirements in May, 2012,[4] the proposed amendments to the aggregation requirements in November, 2013,[5] and the petition filed by market participants requesting additional hedging relief under section 4a(a)(7) of the Commodity Exchange Act ("CEA").[6]

II. Summary of FIA's Comments and Recommendations

For the convenience of the Commissioners and Commission Staff, set forth below is a high-level summary of FIA's comments on, and recommendations concerning, the Proposed Rule. FIA's comments and recommendations have been prepared based upon extensive consultation with FIA regular and associate members. They reflect the collective experience of market participants who hedge risk in connection with their commercial operations, act as intermediaries in the market, comply with existing Commission and exchange speculative position limit rules, and who attempted to implement former Part 151 before the United States District Court of the District of Columbia vacated the rule.[7] FIA's comments and recommendations also are based on its members' expectations about the impact that the Proposed Rule will have on their businesses and the U.S. derivatives markets.

FIA is concerned that various aspects of the Proposed Rule will have a negative impact on the price discovery function and liquidity of physical commodity and economically-equivalent derivatives contracts subject to speculative position limits. FIA also is concerned that the Proposed Rule will significantly restrict the ability of market participants to rely on the derivatives markets to hedge risk, which is one of the fundamental purposes of these markets.[8] In addition, several aspects of the Proposed Rule impose substantial compliance and reporting burdens on market participants where less costly and restrictive alternatives would still enable the CFTC to achieve its regulatory objectives.

Commodity Futures Trading Comm'n (May 25, 2011), *available at* http://www.futuresindustry.org/downloads/AggregationPositionLimitsforDerivatives052511.pdf.

3 *See Position Limits for Futures and Swaps*, 76 Fed. Reg. 71626 (Nov. 18, 2011) ("2011 Position Limits Rule"); *see also* Letter from FIA, to Commodity Futures Trading Comm'n (Jan. 17, 2012), *available at* http://www.futuresindustry.org/downloads/FIA_InteriPositionLimitsonCash-SettledContracts.pdf.

4 *See Aggregation, Position Limits for Futures and Swaps*, 77 Fed. Reg. 31767 (May 30, 2012) (proposed rule); *see also* Letter from FIA, to Commodity Futures Trading Comm'n (June 29, 2012), *available at* http://www.futuresindustry.org/downloads/Aggregation-NOPR-Comments-062912.pdf.

5 *See Aggregation of Positions*, 78 Fed. Reg. 68946 (Nov. 15, 2013) ("Proposed Aggregation Rule"); *see also* Letter from FIA, to Commodity Futures Trading Comm'n (Feb. 6, 2014) (on file with the CFTC).

6 *See* Petition from the Working Group of Commercial Energy Firms, to Commodity Futures Trading Comm'n (Jan. 20, 2012), *available at* http://www.cftc.gov/stellent/groups/public/@rulesandproducts/documents/ifdocs/wgbfhpetition012012.pdf; *see also* Petition from FIA, to Commodity Futures Trading Comm'n (Mar. 26, 2012) ("FIA March 2011 Petition"), *available at* http://www.futuresindustry.org/downloads/WorkingGroupPetitions032612.pdf.

7 *See Int'l Swaps and Derivatives Ass'n v. U.S. Commodity Futures Trading Comm'n*, 887 F. Supp. 2d 259 (D.D.C. 2012), *appeal dismissed*, 2013 U.S. App. LEXIS 22618 (D.C. Cir. Nov. 6, 2013).

8 *See* CEA section 3(a).

To ensure that any rule ultimately adopted by the Commission has a sound legal and factual basis, FIA urges that the Commission defer imposing of speculative position limits until after it has collected and analyzed the data necessary to make an empirical finding that speculative position limits are "necessary" to "diminish, eliminate or prevent" the burden on interstate commerce caused by excessive speculation, and that the limit levels proposed by the Commission are "appropriate." Should the Commission choose to move forward with speculative position limits without making a necessity finding based upon empirical data as required by the CEA, FIA requests that the CFTC amend the Proposed Rule consistent with the following comments and recommendations:

- The Commission should adopt the CME Group's estimated levels of deliverable supply for the commodities that underlie Core Referenced Futures Contracts ("CRFC") so that any spot month speculative position limits set by the Commission reflect current, rather than outdated and inaccurate, deliverable supply.

- When considering whether to adjust spot month limits in the future, the Commission should include supply that is subject to long-term supply contracts within the scope of deliverable supply. In addition, the Commission should consult with the exchanges and commercial market participants regarding the scope of deliverable supply of each commodity to ensure that spot month position limits reflect current levels of estimated deliverable supply.

- The definition of the spot month for federal limits should be the same as the definition of spot month for purposes of any exchange limits. In addition, the Commission, like the exchanges, should publish a calendar that identifies the spot month for each CRFC.

- The proposed prohibition against holding a single physical-delivery Referenced Contract in order to be eligible for the higher spot month limits for cash-settled contracts should be eliminated because it is not necessary to prevent excessive speculation or manipulation.

- The Commission should not impose non-spot month speculative position limits. Rather, it should establish position accountability levels on single month and all-months-combined positions in Referenced Contracts because hard limits on these positions are neither necessary nor appropriate and will unnecessarily restrict legitimate commercial activity.

- Should the Commission decide to set hard single month and all-months-combined speculative position limits, it should use the open interest data that it has collected for all Referenced Contracts to calculate appropriate levels for such limits. If the Commission's open interest data for Referenced Contracts are incomplete, the Commission should delay the imposition of hard non-spot month limits until the Commission has collected and evaluated complete data.

- If the Commission sets hard non-spot month speculative position limits, it should adopt equivalent non-spot month speculative position limits across the three existing wheat Referenced Contracts consistent with its past practice.

- FIA supports the Commission's proposal to provide a market participant with flexibility to use the prior day's delta to calculate the futures-equivalent position for options for purposes of complying with a speculative position limit. FIA recommends that the Commission adopt the long-standing exchange treatment of options positions under which a market participant is not in violation of a speculative position limit if its position exceeds a limit due to changes in delta.

- In order to reduce uncertainty and unnecessary compliance costs, the Commission should publish a comprehensive list of Referenced Contracts, or at a minimum, a comprehensive list of Referenced Contracts traded on designated contract markets ("DCMs") and swap execution facilities ("SEFs"), as part of the final rule and Staff's Referenced Contract Workbook.

- Because commodity index contracts serve as an important risk-management tool for pension funds and other vehicles to hedge the risk of inflation, the Commission's netting rules should not restrict the ability of market participants to make commodity index contracts available to the market. Accordingly, the Commission should allow a market participant that makes these products available to net the positions of the commodity index contract against Referenced Contracts used to hedge the exposure of the commodity index contract. Alternatively, the Commission should establish an exemption for Referenced Contracts that hedge exposure to commodity index contracts.

- For purposes of the definition of basis contracts, which are excluded from position limits, the Commission should expand the list of commodities in Appendix B that are substantially the same as a CRFC. The scope of commodities that are substantially the same in Appendix B should reflect the commercial practices of market participants.

- Trade options should be excluded from the definition of Referenced Contract so they will not be subject to position limits. For many reasons explained below, the compliance burdens and costs of subjecting trade options to speculative position limits greatly exceed any regulatory benefit.

- Market participants should have the ability to make commercially reasonable decisions about whether to hedge all or some components of portfolios of risk.

- The Commission should continue to permit legal entities within an aggregated group to rely on separate *bona fide* hedging exemptions, rather than requiring them to manage *bona fide* hedging exemptions on an aggregated basis.

- The Commission should retain its long-standing substantially related qualitative factor for determining whether a cross-commodity hedge qualifies as a *bona fide* hedging position, but eliminate the proposed quantitative factor because the quantitative factor: (a) is not adequately supported, (b) does not take into account long-term price correlation between substantially related commodities, (c) is inconsistent with long-standing commercial practices, and (d) would preclude market participants from entering into *bona fide* hedging transactions and positions permitted by the CEA.

- The Commission should: (a) expand the list of enumerated hedging positions to permit common risk reducing practices, (b) not restrict *bona fide* hedging positions in the spot month, and (c) re-institute a Division of Market Oversight ("DMO") Staff-administered process with objective standards and time limits for market participants to seek non-enumerated hedging exemptions.

- The Commission should not apply a negligence standard for purposes of determining whether hedging positions have been established and liquidated in an orderly manner. Instead, it should interpret the orderly trading requirement for *bona fide* hedge positions consistently with the Commission's disruptive trading practices interpretation.[9]

- The Commission should continue to grant risk-management exemptions because non-speculative positions should not be subject to speculative position limits.

- The position limits reporting requirements should be modified so that they are commercially practicable and provide the Commission with information that it can review and analyze with the resources available to it.

- The Commission should authorize DCMs to establish position accountability levels in lieu of hard limits outside of the spot month. In addition, the Commission should not require market participants to apply for an exemption to net offsetting positions on another exchange or in the OTC market. Such a requirement creates the risk that decisions about whether to grant, and the scope of, an exemption may be affected by competitive considerations between and among DCMs and SEFs, and may inappropriately restrict or eliminate the benefits of netting for purposes of the federal limits.

- The Commission should exempt SEFs from any requirement to enforce compliance with federal speculative position limits or establish SEF speculative position limits for contracts subject to federal limits. Alternatively, SEFs should only be required to provide data to the Commission to assist it in monitoring compliance with federal speculative position limits.

- To ensure that the proposed exemption for an "eligible affiliate" covers sister affiliates, the Commission should define it consistently with the definition of "eligible affiliate counterparty" under CFTC Rule 50.52.

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9 *See Antidisruptive Practices Authority*, 78 Fed. Reg. 31890 (May 28, 2013).

- Because of the complexities and costs involved in implementing federal and exchange-set speculative position limits, the Commission should provide market participants with an extended transition period of not less than nine months from the date on which the final rule is issued to comply with any final speculative position limits rule.

III. The Commission Should Analyze Position and Pricing Data Before Finding That Position Limits Are Necessary

In the preamble to the Proposed Rule, the Commission interprets section 4a of the CEA, as amended by the Dodd-Frank Act, to mandate that the CFTC impose speculative position limits on all physical commodity futures contracts and all economically equivalent futures and swaps.[10] As a result, the Commission asserts that section 4a(a)(2) does not require it to make a finding that speculative position limits are necessary for physical commodity contracts, or that the levels of its proposed limits are appropriate, prior to imposing such limits. Nevertheless, "out of an abundance of caution," the Commission makes a qualitative finding that speculative position limits are necessary, and that the proposed limit levels are appropriate.[11] The Commission takes the position that section 4a of the CEA includes a mandate to impose speculative position limits notwithstanding the language in section 4a(a)(2) that expressly states that the Commission shall impose any limits "in accordance with the standards in paragraph (1)."

In the District Court decision overturning the Commission's Part 151 speculative position limits rule, the Court found that section 4a(a)(1) of the CEA expressly requires that the Commission make a finding that speculative position limits are necessary prior to imposing speculative position limits.[12] Based on the District Court decision and the plain language of CEA section 4a(a)(2), FIA submits that the Commission cannot impose limits unless it complies with *all* of the standards in CEA section 4a(a)(1), *including* the requirement to make a finding that speculative position limits are necessary. Although the Commission proposes an alternative qualitative finding that speculative position limits are necessary, that finding is predicated incorrectly on the premise that speculative position limits, as a general matter, are necessary to prevent excessive speculation.[13]

The Commission did not undertake an empirical analysis of available data to determine that speculative position limits are, in fact, necessary for each contract subject to the proposed limits. Furthermore, the Commission did not define excessive speculation or identify why

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10 Proposed Rule at 75681-75685.

11 *Id.* at 75685.

12 *Int'l Swaps and Derivatives Ass'n*, 887 F. Supp. 2d at 270.

13 The one litigated case and the reports cited by the Commission do not support a finding that federal position limits are necessary to prevent manipulation or excessive speculation. Moreover, as also discussed below, the Commission has not demonstrated how the existing regime of exchange-set speculative position limits and position accountability levels is insufficient to prevent excessive speculation or manipulation. *See* section IV.D., *infra* (FIA's discussion of the absence of a need for non-spot month position limits).

positions above the proposed limit levels constitute excessive speculation. By substituting a qualitative, rather than an empirical, analysis, the Commission effectively, but incorrectly, concludes that speculative position limits are *always* necessary because of their *potential* to prevent excessive speculation.

FIA requests that the Commission evaluate the futures, options, and swaps position data in its possession and perform a quantitative analysis for each contract that it proposes to subject to speculative position limits. This analysis should determine, for each Referenced Contract, the level at which speculation becomes *excessive* speculation and demonstrate why positions in excess of the particular limit harm the market. The Commission should not simply rely on an arbitrary and unsupported general statement that large positions "could" harm the market. Absent an empirical analysis, the Commission cannot make the statutorily required finding that speculative position limits are necessary, that the levels established provide sufficient liquidity for *bona fide* hedgers, or that the price discovery function of the underlying market will not be disrupted.[14]

Notably, in its review of available studies regarding speculative position limits, the Commission concluded that "[t]here is a demonstrable lack of consensus in the studies."[15] This admitted lack of consensus provides no support for a qualitative or quantitative finding that position limits are necessary to prevent excessive speculation. Given the considerable costs associated with the Proposed Rule, FIA respectfully submits that the Commission should not adopt the approach of "when in doubt regulate." Rather, it should first make an appropriately considered finding based on an empirical analysis of reliable and objective position data that speculative position limits are necessary and, only then, set limit levels that are appropriate. The plain language of CEA sections 4a(a)(1) and 4a(a)(2) obligates the Commission to perform such an empirical analysis in advance of imposing speculative position limits.

IV. The Commission Should Modify Its Proposed Speculative Position Limits

The Proposed Rule establishes hard spot month and non-spot month speculative position limits on 28 CRFCs and futures, options, and swaps that are economically equivalent to the 28 CRFCs (collectively "Referenced Contracts"). If, despite the statutory requirement that the Commission must find, based upon objective, empirical data, that speculative position limits are necessary, the Commission nevertheless elects to move forward with a final speculative position limits rule, FIA requests that the Commission make the following modifications to the proposed spot month and non-spot month speculative position limits.

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14 *See* CEA section 4a(a)(3).

15 Proposed Rule at 75694.

A. The Proposed Spot Month Limits Should Reflect Accurate Estimates of Deliverable Supply

The Proposed Rule establishes separate spot month speculative position limits for physical-delivery Referenced Contracts and cash-settled Referenced Contracts.[16] These limits are based on current DCM limits, which, in turn, are based on 25 percent of the estimated deliverable supply of the commodities that underlie the CRFCs.[17] For the initial limits, the Commission proposes to rely upon the existing spot month speculative position limits in place across the exchanges that list the 28 CRFCs.[18] However, the Commission also requested comment on the alternative estimates of deliverable supply submitted by the CME Group.[19]

1. The Commission Should Adopt the CME Group's Estimates of Deliverable Supply

FIA supports the CME Group's alternative estimates of deliverable supply of the commodities that underlie CRFCs. Historically, the Commission has deferred to the exchanges' experience, expertise and access to reliable data for estimating the level of deliverable supply.[20] FIA recommends that the Commission continue to follow its practice of relying upon the exchanges in this area and adopt the CME Group's estimates of deliverable supply for purposes of setting spot month speculative position limits.

If the Commission believes that 25 percent of estimated deliverable supply is an appropriate basis for establishing spot month limits, then the Commission should rely on the most current levels of estimated deliverable supply available; namely, the CME Group's estimates. The large disparity between historic estimates and the CME Group's current estimates demonstrates that the prior estimates *need* to be updated and that the CFTC should validate and rely upon the CME Group's alternative estimates. Any limits based on outdated and inaccurate estimates would likely be overly restrictive and may limit the liquidity available to *bona fide* hedgers.[21] The lack of liquidity also may impede the price discovery function of Referenced Contracts in the spot month.

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16 Proposed Rule 150.2(a).

17 Proposed Rule at 75729.

18 *Id.* at 75727.

19 *Id.* (table 9).

20 *See* 2011 Position Limits Rule at 71669 ("Given that DCMs that list Core Referenced Futures Contracts have considerable experience in estimating deliverable supply for purposes of position limits, this expertise will be of significant benefit to the Commission in its determination of levels of deliverable supply for the purpose of resetting spot month position limits. The additional data provided by DCMs will help the Commission to accurately determine the amounts of deliverable supply, and therefore the proper level of spot-month position limits.").

21 *See* CEA section 4a(a)(3)(B)(iii).

2. The Definition of Deliverable Supply Should Include Supply that Is Subject to Long-Term Supply Contracts

In the Proposed Rule, the Commission adopts the general definition of "deliverable supply" from the guidance in Appendix C to Part 38.[22] The Commission also notes that:

> [t]ypically, deliverable supply reflects the quantity of the commodity that potentially could be made available for sale on a spot basis at current prices at the contract's delivery points. For a physical-delivery commodity contract, this estimate might represent product which is in storage at the delivery point(s) specified in the futures contract or can be moved economically into or through such points consistent with the delivery procedures set forth in the contract and which is available for sale on a spot basis within the marketing channels that normally are tributary to the delivery point(s).[23]

The Commission's guidance presumes that deliverable supply "would not include supply that is committed for long-term agreements (*i.e.*, the amount of deliverable supply that would not be available to fulfill the delivery obligations arising from current trading). . . . However, if the estimated deliverable supply that is committed for long-term agreements, or significant portion thereof, can be demonstrated by the [DCM] to be consistently and regularly made available to the spot market for shorts to acquire at prevailing economic values, then those 'available' supplies committed for long-term contracts may be included in the [DCM's] estimate of deliverable supply for that commodity."[24] The market structure for many physical commodities, particularly energy commodities, is such that quantities subject to long-term supply arrangements are regularly made available to the spot markets because the sellers can obtain supply from alternative sources to meet their forward commitments. Accordingly, FIA submits that for purposes of establishing spot month speculative position limits in the future, the Commission should presume that supply from long-term contracts is consistently and regularly available in the spot market.

3. When Setting Limits in the Future, the Commission Should Consult with Exchanges and Commercial Market Participants Regarding the Scope of Deliverable Supply

When considering whether to adjust spot month limits in the future, FIA also recommends that the Commission continue to consult with the exchanges and commercial market participants regarding the scope of deliverable supply of each commodity to ensure that spot month position limits reflect then current levels of estimated deliverable supply. The

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[22] *See Core Principles and Other Requirements for Designated Contract Markets*, 77 Fed. Reg. 36612, 36722 (Jun. 19, 2012).

[23] Proposed Rule at 75729 n.412.

[24] *See* 17 C.F.R. pt. 38, app. C, para. (b)(1)(i)(A) (2013).

Commission needs a thorough understanding of the supply characteristics and commercial settlement and delivery practices for each Referenced Contract before it can determine the most appropriate parameters to use when setting spot month position limits. If the Commission conducts the necessary diligence, it will be able to set spot month limits for Referenced Contracts that are not based on an overly restrictive definition of deliverable supply.

B. The Commission Should Define the Spot Month for Federal Limits Consistently with the Definition of the Spot Month for Any Exchange Limits and Publish a Calendar of the Spot Month for Each Core Referenced Futures Contract

The Proposed Rule includes a definition of the spot month for physical-delivery and cash-settled contracts, which establishes the period during which spot month speculative position limits apply to a Referenced Contract.[25] FIA has identified instances where the current exchange spot month definition is inconsistent with the Proposed Rule. For example, the proposed definition of the spot month for the ICE Futures U.S. ("IFUS") Sugar No. 11 futures contract (SB) states that it commences "at the close of trading on the trading day preceding [first notice day]."[26] By comparison, under the current IFUS definition, the spot month commences "as of the opening of trading on the second (2nd) Business Day following the expiration of the regular Option traded on the expiring Exchange Futures Contract."[27] As another example, the proposed definitions of spot month for the COMEX Gold futures contract (GC), Silver futures contract (SI), and Copper futures contract (HG) state that they commence "at the close of trading on the trading day preceding [first notice day]," whereas the current COMEX definitions refer to the "*close of business* on the business on the business day prior to the first notice day."[28]

FIA requests that the Commission ensure that the definition of the spot month for the federal limits is the same as the definition of the spot month for exchange limits for all Referenced Contracts.[29] FIA also recommends that the spot period commence as of the "close of business" on the day prior to the specified day as opposed to as of the "close of trading." Referring to the "close of business" allows market participants, consistent with current market practice, to incorporate any exchange of futures for related position ("EFRP") transactions that occur after the close of trading, but before the close of business. In addition, although the Proposed Rule generally defines spot month, FIA requests that the Commission, like the exchanges, publish spot month calendar for each CRFC to provide market participants with

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[25] Proposed Rule 150.1(definition of "Spot month").

[26] *Id.* (definition of "Spot month," paragraph (1)).

[27] IFUS Rule 6.22(b).

[28] *See* NYMEX & COMEX: Position Limits, Position Accountability Levels and Reportable Position Levels, CME GRP., http://www.cmegroup.com/market-regulation/position-limits/ (last visited Feb. 4, 2014) (emphasis added).

[29] FIA presumes that the Commission did not intend to create differences in the length of the spot month for federal limits compared to exchange limits.

clarity about when spot month limits apply. The calendar would significantly reduce the cost of identifying and tracking the spot month as part of a market participants' implementation of systems and procedures designed to comply with spot month speculative position limits.

C. The Commission Should Not Condition Higher Limits for Cash-Settled Contracts

The Proposed Rule establishes a higher spot month limit for cash-settled Referenced Contracts. However, as a condition to relying on the higher spot month limits, a market participant cannot hold any positions in the physical-delivery Referenced Contract.[30] If a market participant complies with this condition, then under the Proposed Rule it can hold spot month positions in cash-settled Referenced Contracts up to five times the level of the spot month limit.[31]

FIA supports higher limits for cash-settled contracts because, as the Commission has stated in the past, they are less susceptible to manipulation and excessive speculation.[32] However, FIA sees no basis for restricting the availability of higher limits for cash-settled contracts to market participants that do not hold positions in the physical-delivery Referenced Contract. According to the Commission, the conditional limit may prevent a market participant from manipulating the price of a physical-delivery contract to benefit cash-settled positions.[33] There is no basis for presuming that this is a widespread practice or that it is even possible, absent fraud, to manipulate open markets for the sustained period that would be necessary for such a scheme to achieve its assumed objective. FIA is concerned that the Commission has not sufficiently considered the potential impact that its proposed solution to this unsubstantiated problem may have on the price discovery function and liquidity of Referenced Contracts.

Holding a single position, or even multiple positions up to the speculative limit, in a physical-delivery Referenced Contract cannot constitute excessive speculation or enable a market participant to manipulate the price of a CRFC. Nevertheless, the Commission would treat holding a single contract or position under the speculative limit in a physically settled CRFC as "excessive" for every market participant that relies on the conditional spot month speculative limit. If, as the Commission has stated, holding positions in a physical-delivery Referenced Contract within the spot month speculative position limit is not excessive speculation and is not likely to increase the risk of manipulation, then the Commission should not restrict a trader's ability to hold a spot month position in that same cash-settled Referenced Contract up to five times the limit.[34]

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[30] Proposed Rule 150.3(c).

[31] *Id.*

[32] *See* Former CFTC Rule pt. 38, app. B, core prin. 5, para. (b)(2) (2010). The Commission previously stated that the potential for distortion of prices is "negligible" for cash-settled contracts.

[33] Proposed Rule at 75737.

[34] CFTC Staff have advised FIA that trade options are physical-delivery Referenced Contracts under the Proposed Rule and a single trade option prohibits a market participant from relying on the conditional limit. As discussed in

Rather than establishing a conditional limit on cash-settled Referenced Contracts that prohibits a market participant from holding a position in a physically-settled Referenced Contract, the Commission should rely on its broad anti-manipulation authority to address any concerns that it has regarding trading a physical-delivery contract to benefit a cash-settled position. Both the Commission and the exchanges have the ability to monitor trading in the spot month and should be able to detect and prosecute improper trading activity.

D. The Commission Should Adopt Position Accountability Levels Rather than Hard Non-Spot Month Speculative Position Limits; Alternatively, Hard Limits Should Be Based on Complete Open Interest Data

The Proposed Rule establishes hard non-spot month speculative position limits on Referenced Contracts that are based on 10 percent of open interest for the first 25,000 contracts and 2.5 percent of open interest thereafter (the "10/2.5 Formula"). FIA respectfully submits that the Commission has not established any empirical basis for imposing non-spot month limits. To the extent that the Commission is determined to address positions outside of the spot-month, it should adopt position accountability levels as a more flexible and less burdensome alternative to hard non-spot month limits. Should the Commission nevertheless impose hard non-spot month limits, it should use the open interest of all Referenced Contracts when calculating limits based on the 10/2.5 Formula. If the Commission chooses to disregard in its calculation of open interest a portion of the transactions in Referenced Contracts, any non-spot month limits that it sets will not accurately reflect the 10/2.5 Formula and, under the Commission's own methodology, likely will result in overly restrictive limits.

1. The Commission Should Adopt Accountability Levels in Lieu of Hard Speculative Position Limits

As FIA has previously recommended, the Commission should adopt federal accountability levels rather than hard limits outside of the spot month.[35] For more than a decade, DCMs, the entities on the front line of monitoring for and preventing excessive speculation, have been strong proponents of accountability levels.[36] Market participants, in turn, have operated their businesses and conducted their trading activities in compliance with exchange position accountability frameworks. During this period, the markets generally have remained liquid, provided efficient price discovery, and remained free from any significant disruption. And, neither the Commission nor the exchanges have suggested that accountability levels are ineffective at deterring excessive speculation or manipulation.[37]

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section VIII *infra*, FIA recommends that the Commission exclude trade options from the definition of Referenced Contract.

[35] *See* FIA March 2011 Letter.

[36] *See* Letter from CME Grp., to Commodity Futures Trading Comm'n (Mar. 28, 2011) (on file with the CFTC); *see also* Letter from ICE Futures U.S., to Commodity Futures Trading Comm'n (Mar. 28, 2011), *available at* http://comments.cftc.gov/Handlers/PdfHandler.ashx?id=22130.

[37] For example, the CFTC's Division of Market Oversight (**"**DMO**"**) recently approved the Chicago Mercantile Exchange ("CME") and Chicago Board of Trade ("CBOT") position accountability levels and procedures. *See*

The Commission acknowledges in the Proposed Rule that the threat of "corners and squeezes and other forms of manipulation are reduced [outside of the spot month]."[38] This reduced risk is reflected in the cases and reports cited by the Commission in support of its "necessity" finding and in other CFTC manipulation cases, all of which allege manipulation of the spot month contract.[39] These cases provide no support for the Commission's "finding" that position limits are necessary, or that the levels of the proposed limits are appropriate, outside of the spot month. The reduced threat of manipulation outside of the spot month provides an additional and independent reason for the Commission to set more flexible position accountability levels in lieu of hard non-spot month speculative position limits.

Sections 4a(a)(2) and (3) of the CEA provide the Commission with the discretion to adopt accountability levels rather than hard limits, particularly with respect to non-spot months. Both sections authorize the Commission to set limits "as appropriate" and section 4a(a)(3)(B) lists the factors – including ensuring sufficient liquidity for *bona fide* hedgers and avoiding disruption of the price discovery function of the underlying market – that the Commission must consider in deciding whether to impose speculative position limits. Non-spot month position accountability levels have a demonstrable history of effectively deterring excessive speculation and manipulation while, at the same time, preserving market liquidity and efficient price discovery. Accordingly, there are sound legal and policy reasons why the Commission should consider and adopt federal accountability levels in lieu of hard federal speculative position limits.

If the Commission has any concerns about the availability of Staff resources to monitor compliance with accountability levels, FIA recommends that the Commission rely on the exchanges in the first instance to perform that function. Given the exchanges' experience and expertise monitoring accountability levels, they could request additional information from market participants and order a market participant to decrease its position, if appropriate, to deter and prevent excessive speculation.[40] Federal accountability levels would enable the Commission and the exchanges to determine on a case-by-case basis whether a large position may lead to excessive speculation or a pose realistic threat of price manipulation. As a result, position accountability levels would provide the Commission with an effective and flexible tool to monitor for, and prevent, excessive speculation.

COMMODITY FUTURES TRADING COMM'N, DIV. OF MKT. OVERSIGHT, RULE ENFORCEMENT REVIEW OF THE CHICAGO MERCANTILE EXCHANGE AND THE CHICAGO BOARD OF TRADE (July 26, 2013). DMO also approved the New York Board of Trade's ("NYBOT") (subsequently ICE Futures U.S.) use of position accountability levels. *See* COMMODITY FUTURES TRADING COMM'N, DIV. OF MKT. OVERSIGHT, RULE ENFORCEMENT REVIEW OF THE NEW YORK BOARD OF TRADE (Oct. 26, 2005).

[38] *See* Proposed Rule at 75766.

[39] *See* Attachment A, *infra*. FIA notes that the findings in the report of the Permanent Subcommittee on Investigations of the United States Senate from 2007 regarding Amaranth's impact on prices outside of the spot month are not based on a litigated evidentiary record. Moreover, as the Commission acknowledges in the Proposed Rule, many other studies reached different conclusions. *See* Proposed Rule at 75694.

[40] *See, e.g.*, CME Rule 560.

2. *The Commission Should Not Adopt Hard Non-Spot Month Speculative Position Limits Based on Incomplete Data*

If the Commission nevertheless determines to impose speculative position limits outside of the spot month based on the 10/2.5 Formula, it should include the open interest of *all* of the Referenced Contracts when calculating non-spot month limits. The Proposed Rule only considers open interest during calendar years 2011 to 2012 for futures contracts, options on futures contracts, and significant price discovery contracts that are traded on exempt commercial markets. It ignores the volume of OTC transactions in Referenced Contracts for which the Commission has collected detailed information.[41] The Commission declined to rely on open interest data from the Part 20 swaps large-trader reporting data, apparently because of some unspecified inaccuracies in the data.[42] In addition, the Commission declined to rely on swap data reported to swap data repositories ("SDRs") in accordance with Parts 43, 45, and 46 of the Commission's rules.

The Commission should not establish non-spot month limits on all Referenced Contracts based on an incomplete set of data. Under vacated Part 151, the Commission refrained from setting non-spot month limits until it had collected 12 months' of open interest for futures, options on futures, and "all of a Referenced Contract's month-end open swaps positions, considering open positions attributed to both cleared and uncleared swaps."[43] The Commission should adopt this same approach in the Proposed Rule and wait to establish non-spot month limits until after it has open interest data for the entire market.

To the extent that the Commission proceeds with the 10/2.5 Formula, it should include the open interest of all Referenced Contracts in the formula. Otherwise, any non-spot month limits adopted by the Commission would not accurately represent the expected results of applying the 10/2.5 Formula to all open interest, but rather would reflect a calculation based on an incomplete and, therefore, inaccurate subset of those data. The proposed non-spot month limits necessarily would then be overly restrictive under the Commission's own formula – a result that the Commission is required by statute to avoid.

3. *The Commission Should Adopt Equivalent Non-Spot Month Speculative Position Limits Across the Three Wheat Referenced Contracts*

The Proposed Rule sets non-spot month speculative position limits at 16,200 contracts for the Chicago Board of Trade ("CBOT") Wheat contract, 6,500 contracts for the Kansas City Board of Trade ("KCBT") Hard Winter Wheat contract, and 3,300 contracts for the Minneapolis Grain Exchange ("MGX") Hard Red Spring Wheat contract. Should the Commission decide to adopt hard non-spot month speculative position limits, FIA recommends that the Commission adopt equivalent non-spot month speculative position limits for these three wheat contracts.

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[41] *See* Proposed Rule at 75730.

[42] *See id.* at 75733-34.

[43] *See* Former CFTC Rules 151.4(b)(2)(i)(C), 151.4(d)(3)(i).

The Commission's currently in effect Part 150 rules establish the same non-spot month speculative position limits of 12,000 contracts for the CBOT, KCBT, and MGX wheat contracts. FIA is concerned that different limits for the same type of commodity could impact the growth of, and the potential for risk mitigating strategies between, the three wheat contracts. These contracts provide market participants with tools to mitigate the risks arising from changing domestic and global market fundamentals that could have varying impacts on the different varieties of wheat. In addition, these three contracts provide market participants with the opportunity to reduce risk through spread trades. For these reasons, FIA requests that the Commission adopt equivalent non-spot month limits for the three wheat Referenced Contracts.

E. The Commission Should Confirm that a Change in Option Delta Cannot Result in a Speculative Position Limit Violation

Under the Proposed Rule, speculative position limits apply to a market participant's futures-equivalent position. To calculate the futures-equivalent position for an option contract, the Proposed Rule provides that the option should be "adjusted by an economically reasonable and analytically supported risk factor, or delta coefficient, for that option computed as of the previous day's close or the current day's close or contemporaneously during the trading day."[44]

FIA supports the Commission's definition of futures-equivalent, which enables a market participant to use the prior day's delta to calculate its futures-equivalent position toward a speculative position limit. FIA requests that the Commission confirm that if a market participant's end-of-day futures-equivalent position includes options, and its speculative positions are over the limit based on the current day's delta, but are not over the limit based on the prior day's delta, then such positions do not constitute a violation. For example, a market participant may use the prior day's (day 1) delta to determine that its position on day 2 is under the speculative position limit. If the market participant's position at the open of trading on day 3 exceeds the speculative position limit because of the change in delta from day 1 to day 2, then the position should not constitute a speculative position limit violation on day 3. In this instance, the Commission should provide the market participant with a reasonable period of time, consistent with the long-standing exchange rules described below, to reduce its position below the speculative position limit.

The exchanges apply this long-standing practice to account for the impact of delta volatility on speculative positions. For example, CME Rule 562 provides: "if, at the close of trading, a position that includes options exceeds position limits when evaluated using the delta factors as of that day's close of trading, but does not exceed the limits when evaluated using the previous day's delta factors, then the position shall not constitute a position limit violation." Similarly, IFUS Rule 6.13(a) states that "[m]embers are responsible for maintaining their positions and their Customers' positions within the limits contained in this Chapter on both an intraday and end-of-day basis. If, however, a Member's or Customer's position exceeds speculative limits on any given Business Day due to changes in the deltas of the options, the

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[44] *See* Proposed Rule 150.1 (definition of "Futures-equivalent," paragraph (1)).

Member or Customer shall have one (1) Business Day to bring the position within the limits." Given the long-standing exchange practice of recognizing the impact of delta volatility in connection with position limits, the Commission should confirm that it will adopt the same policy.

V. The Commission Should Publish a Comprehensive List of Referenced Contracts, or at a Minimum, a List of All Referenced Contracts Traded on DCMs and SEFs

The proposed definition of a Referenced Contract includes: (1) CRFCs and (2) futures, options, or swaps that are (a) "[d]irectly or indirectly linked, including being partially or fully settled on, or priced at a fixed differential to, the price of that particular CRFC; or [(b)] directly or indirectly linked, including being partially or fully settled on, or priced at a fixed differential to, the price of the same commodity underlying that particular [CRFC] for delivery at the same location or locations as specified in that particular [CRFC]."[45] This definition is complex and susceptible to multiple and different good faith interpretations.

CFTC Staff also published a non-exclusive list of contracts it considers to be Referenced Contracts, along with contracts that it does not consider to be Referenced Contracts.[46] If a contract or index is not identified on the non-exclusive list, then the contract or index *may or may not* constitute a Referenced Contract. FIA appreciates the Staff publishing this list. However, in order to provide market participants with sufficient clarity about the scope of the definition of Referenced Contract, FIA requests that the CFTC publish a comprehensive list of Referenced Contracts, or at a minimum, all such contracts traded on DCMs and SEFs.[47] A comprehensive list would reduce uncertainty and compliance costs because market participants will have a clear understanding of the scope of Referenced Contracts subject to speculative position limits.

Without further guidance, market participants will be subject to the risk of making incorrect and inconsistent determinations about which contracts are Referenced Contracts. In addition, FIA anticipates that market participants will need to invest significant resources to identify contracts subject to speculative position limits. A comprehensive list of Referenced Contracts would greatly reduce the unnecessary risks and costs related to attempting to identify Referenced Contracts.

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45 *See id.* (definition of "Referenced Contract").

46 *See Position Limits Workbook*, COMMODITY FUTURES TRADING COMMISSION, http://www.cftc.gov/LawRegulation/DoddFrankAct/Rulemakings/PositionLimitsforDerivatives/ssLINK/poslimitsworkbook (last visited Jan. 28, 2014).

47 If the list of Referenced Contracts evolves over time, the Commission should provide market participants with advance notice so they will have sufficient time to incorporate additional Referenced Contracts into their compliance policies and procedures.

VI. Speculative Position Limits Should Not Be Used to Restrict the Availability of Commodity Index Contracts to Manage Risk

The Commission proposes to exclude commodity index contracts from the definition of Referenced Contract.[48] The Commission defines a commodity index contract as "an agreement, contract, or transaction that is not a basis or any type of spread contract, based on an index comprised of prices of commodities that are not the same or substantially the same." Under this definition, swaps that reference indices such as the Goldman Sachs Commodity Index ("GSCI") or the Dow Jones UBS Commodity Index are excluded from the definition of a Referenced Contract and, therefore, are not subject to speculative position limits. As a result, commodity index swaps cannot be netted against the Referenced Contract positions used to hedge the risks associated with those swaps.

Commodity index contracts provide pension funds, endowments, and other vehicles with an important tool for managing the risks and costs of inflation because the expected return on such index contracts is correlated to inflation, expected inflation, and changes to expected inflation.[49] To accommodate the need of a pension fund, endowment, or other vehicle to hedge inflation risk, a swap dealer may sell the fund a commodity index contract and then hedge its risk on the index swap by buying the CRFC components of the commodity index swap. The swap dealer's futures positions do not fall within the Commission's proposed list of enumerated hedging positions. However, those futures positions plainly are not speculative positions. Because the Commission proposes to exclude commodity index contracts from the definition of Referenced Contract, when a swap dealer hedges commodity index contracts with Referenced Contracts, the hedges count toward speculative position limits, and cannot be netted against the offsetting commodity index contract positions.[50]

According to the Commission, to "mitigate" the impact of the absence of netting, a swap dealer could structure a commodity index contract by entering into "multiple" swap positions to replicate a single commodity index contract. In other words, each individual swap would represent a weighted component of the commodity index contract, such as the NYMEX crude oil component of the GSCI. Because the single commodity swaps constitute Referenced Contracts, when a swap dealer hedges its exposure with offsetting Referenced Contracts (*e.g.*, the NYMEX crude oil futures contract), the swap dealer's positions from the single commodity swaps that represent components of the commodity index contracts would net against Referenced Contracts that hedge the individual swap positions.[51]

FIA requests that the Commission either continue to provide exemptions for market participants that need to use non-speculative Referenced Contract positions to manage the risk of

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[48] *See* Proposed Rule 150.1 (definition of "Referenced Contract").

[49] *See* N. Amec et al., *Inflation-Hedging Properties of Real Assets and Implications for Asset-Liability Management Decisions*, 35 J. Portfolio Mgmt. 94 (2009).

[50] Proposed Rule at 75740-41.

[51] *See id.*

exposure to commodity index contracts, or provide a mechanism that would enable market participants to net Referenced Contracts with commodity index contracts. Attempting to replicate a commodity index contract through multiple single commodity swaps, as suggested by the Commission, is a commercially impractical alternative for swap dealers and their clients who use Referenced Contracts to manage risk, rather than to speculate. FIA members anticipate that it will be complex, difficult, and expensive to attempt to replicate a published index with individual swaps because published indices, such as the GSCI, use complex formulas to rebalance the components of the index on an annual basis.[52] In addition, published indices incorporate complex methodologies designed to replicate the rolling of actual positions in the underlying contracts. It is unclear how market participants could replicate commodity index contracts with single commodity swaps for each component and retain the re-balancing and rolling features of the published index.

When swap dealers use Referenced Contracts to hedge exposure to commodity index contracts, the Referenced Contract positions are risk reducing and not speculative. The Commission's rules should not create disparate treatment of risk reducing positions (hedging positions versus risk-management positions) or deter swap dealers from reducing risk with Referenced Contracts. Moreover, by limiting the ability of swap dealers to hedge the risks associated with index contracts, the Commission will inhibit the development of new products that, as noted above, serve as important risk-management tools for pension funds, endowments, and other vehicles. Finally, to the extent that the Commission makes it difficult for market participants to hedge index exposure with individual futures contracts, the Commission's speculative position limits likely may reduce liquidity in the futures markets, a result the CEA expressly seeks to avoid.

Alternatively, as FIA requests in section IX.H below, the Commission should provide swap dealers with limited risk-management exemptions to hedge exposure from commodity index swaps. The Commission's proposed netting restrictions impose significant constraints on the ability of swap dealers and intermediaries to reduce risk with non-speculative positions. Consistent with the over-arching risk reduction goals of the Dodd-Frank Act, the Commission should accommodate the need of swap dealers to manage the risks associated with commodity index contracts.

VII. The Definition of Basis Contracts Should Reflect Current Commercial Practices

Under the Proposed Rule, the Commission excluded basis contracts from the definition of Referenced Contract. Generally, basis contracts are cash-settled transactions based on the difference in the price of a CRFC (including a commodity deliverable at par, premium, or discount to a CRFC) and the price of a commodity that is the same (including a commodity deliverable at par, premium, or discount to a CRFC) or substantially the same as the commodity underlying a CRFC. In Appendix B to the Proposed Rule, the Commission listed commodities

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[52] GOLDMAN SACHS, *The GSCI Manual: A Guide to the Goldman Sachs Commodity Index* (Dec. 2004), http://www.goldmansachs.com/gsci/docs/GSCI_Manual_2005_FINAL.pdf.

that it considers to be "substantially the same" to the commodity underlying a CRFC for purposes of the basis contract definition. FIA has reviewed the list of contracts that the Commission identifies as substantially the same to a commodity underlying a CRFC and believes that the CFTC should expand the list to provide that:

- Jet fuel (54 grade) is substantially the same as heating oil (67 grade).

Additionally, FIA requests that the Commission include the following contracts listed for Light Louisiana Sweet (LLS) Crude Oil:

- WTI Midland (Argus) vs. WTI Financial Futures.

FIA also recommends that the Commission adopt a flexible process for identifying any additional commodities that are substantially the same as a commodity underlying a CRFC. This process should take into account the fact that DCMs and SEFs may create new contracts, that markets may develop in new commodities, and that supply and demand fundamentals, as well as contract specifications, may change over time.[53] As a result, the Commission should not require that a commodity be listed in appendix B to constitute "substantially the same" commodity as a commodity underlying a CRFC or that a contract be listed in appendix B to constitute a basis contract. In addition, the Commission should provide market participants with the ability to request an interpretation regarding whether a commodity is "substantially the same" as a CRFC or that a contract qualifies as a basis contract, if needed, and obtain a timely response from the Commission.

VIII. Trade Options Should Be Excluded from the Definition of Referenced Contract

The CFTC proposes that trade options be subject to speculative position limits if they fall within the definition of a Referenced Contract. FIA requests that the Commission exclude trade options from the definition of a Referenced Contract. Trade options are entered into by commercial market participants for purposes related to their business. If the option is exercised, the parties intend physical settlement.[54] In addition, these physical options are more like physical forward and spot contracts, which are not subject to speculative position limits, than they are like Referenced Contracts. For example, market participants use trade options to source physical supply in the same manner as a forward contract. As a result, trade options predominantly represent the physical supply arrangement that a market participant needs to hedge with derivatives.[55]

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[53] FIA notes that many of the contracts listed in Appendix B currently have no volume and no open interest.

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

[55] Should the Commission include trade options within the definition of Referenced Contract notwithstanding that the trade option serves as a physical supply arrangement, market participants may not be able to hedge trade options with other Referenced Contracts unless they qualify as pass-through swaps.

The Commission does not explain or demonstrate why physically-settled options should be subject to speculative position limits or why speculative position limits on trade options are necessary to prevent excessive speculation or manipulation. The burden on market participants associated with speculative position limits on trade options would be substantial. They would be required, for the first time, to track trade options separately from spot and forward contracts, develop systems to calculate the futures contract equivalents for these physical-delivery agreements, and, ultimately, monitor trade option positions for compliance with applicable limits. In addition, given the facts and circumstances analysis associated with determining whether a contract is eligible for the forward contract exclusion, there is significant uncertainty about the distinction between forward contracts and trade options. As a result, one market participant may categorize a transaction as a forward contract while another may categorize the same transaction as a trade option. Given the complexity of monitoring trade options for position limits, FIA submits that the costs associated with imposing position limits on trade options greatly exceed any unstated benefits.

CFTC Staff has advised FIA that trade options are physical-delivery Referenced Contracts under the Proposed Rule. Consequently, if trade options are included in the definition of Referenced Contract, holding a single trade option position would preclude a market participant from holding positions subject to the conditional limit applicable to the corresponding financially settled Referenced Contract(s). This is a disproportionately harsh result that may discourage the use of trade options to manage commercial risk and that would not apply to holding other substantially similar physically-settled contracts, such as spot and forward contracts, that may not provide the same risk-management protection as trade options.

IX. The Definition of *Bona Fide* Hedging Position Should Include Common Commercial Risk-Management Practices

Under the Proposed Rule, the Commission limits the definition of *bona fide* hedging position to a narrow list of enumerated hedging positions and does not provide a mechanism timely to address requests for non-enumerated hedging positions that plainly reduce the risks incurred by commercial enterprises. FIA respectfully submits that the Commission's narrow proposed definition of *bona fide* hedging position impermissibly prohibits long-standing and important commercial risk-management practices specifically authorized in the statutory definition of *bona fide* hedging position in section 4a(c)(2) of the CEA.

In addition, the Commission proposes to restrict the flexibility of market participants to hedge on a net or gross basis, and their ability to rely on cross-commodity hedges. These limitations on the definition of *bona fide* hedging position likely will cause commercial market participants to incur additional risk because these risk reducing positions may be subject to speculative limits.

A. Market Participants Should Have the Ability to Make Commercially Reasonable Decisions about Whether to Hedge All or Some Components of a Portfolio of Risk

Under the Commission's and exchanges' existing speculative position limits regimes, market participants have had the flexibility to determine whether, in the context of their particular businesses and the risks that they incur, to hedge risks on a net or gross basis.[56] In the Proposed Rule, the Commission acknowledged that "gross hedging may be appropriate under certain circumstances, when net cash positions do not measure total risk exposure due to differences in the timing of cash commitments, the location of stocks and differences in grades or types of the cash commodity being hedged."[57] However, in other circumstances, the Commission asserts that a commodity derivative contract would not qualify as a *bona fide* hedging position because the hedge resulted in "increased value exposure of the enterprise."[58]

Market participants need flexibility to hedge the risk in their portfolios on a gross or net basis. Portfolios are dynamic and, as a result, risk managers should have as many tools as possible at their disposal in order to manage risk. For example, market participants may create portfolios of cash-market risk on a legal entity or regional basis. Based on the participant's evaluation of current market conditions, it may decide to hedge fixed-price purchases, but not hedge, or only hedge a portion of, its fixed-price sales. In this instance, the Commission has historically recognized the hedge of the fixed-price purchase as a *bona fide* hedge.[59] Consistent with its long-standing practice, the Commission should continue to let hedgers make commercially reasonable decisions about whether to hedge all or a portion of a portfolio.[60]

FIA agrees that hedging fixed-price purchases, but not fixed-price sales, may increase risk in the limited situation where the fixed-price purchase and sale are at the same time and location and part of the same portfolio of risk. However, the Commission should not use this very limited circumstance to conclude that hedging certain components of a portfolio generally increases risk. In addition, FIA's members assume that any narrow limitation on gross hedging only applies to hedging a particular portfolio of risk and not to cash-market risk at the enterprise level (*i.e.*, all cash-market exposure for all aggregated entities). FIA's members generally hedge cash-market exposure on a legal entity or regional basis, but do not typically create portfolios of risk across all legal entities subject to the Commission's aggregation rules. As long as portfolios of risk are organized based on sound commercial and risk-management principles, market participants should have the flexibility to manage risk and hedge on a portfolio level without regard to other portfolios within the enterprise.

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56 *See Bona Fide Hedging Transactions or Positions*, 42 Fed. Reg. 14832, 14834 (Mar. 16, 1977) ("1977 Proposed Rule").

57 *See* Proposed Rule at 75709.

58 *Id*.

59 *See* 1977 Proposed Rule at 14834. The 1977 Proposed Rule specifically states that the Commission did not intend to restrict or otherwise alter the ability to hedge on a net or gross basis.

60 *See id.*

B. The Commission Should Clarify that Market Participants within an Aggregated Group May Rely on Separate *Bona Fide* Hedging Exemptions

The Commission should continue to permit legal entities within an aggregated group rely on separate *bona fide* hedging exemptions rather than requiring them to apply for and manage *bona fide* hedging exemptions on an aggregated basis. Many corporate groups that will be required to aggregate positions under the Proposed Aggregation Rule operate separate and independent businesses. Although entities that are required to aggregate must calculate their position in Referenced Contracts on an aggregated basis, the Proposed Rule provides eligible affiliates with the option to comply with other aspects of the position limits regime either on a consolidated basis pursuant to proposed CFTC Rule 150.2(c) or individually if they conclude that it is more practical not to rely on such relief.[61]

Consistent with the discretion provided in proposed CFTC Rule 150.2(c), the Commission should clarify that market participants subject to speculative position limits may continue to rely on *bona fide* hedging exemptions on an individual, non-consolidated basis.[62] Separate hedge exemptions for aggregated companies would allow market participants to tailor each request and manage each exemption based upon each company's unique business and risk-management needs. A requirement to apply for and manage an aggregate exemption across multiple businesses is inconsistent with the flexibility afforded under proposed CFTC Rule 150.2(c) and would substantially exacerbate the information technology and compliance costs of certain aggregated entities for which compliance on an individual basis would be more practical.

C. The Commission Should Eliminate the Proposed Quantitative Factor for Cross-Commodity Hedges and Permit Market Participants to Maintain Cross-Commodity Hedges in the Spot Month

Under the Commission's and exchanges' existing rules governing *bona fide* hedging positions, market participants can rely upon a cross-commodity hedging position where the "fluctuations in value of the position for future delivery are substantially related to the fluctuations in value of the actual or anticipated cash positions."[63] Both the Commission and the exchanges have a long and effective track record of administering this requirement. The

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[61] Proposed Rule 150.2(c)(2)(emphasis added); *see also* Proposed Rule 150.1 (defining an "Eligible affiliate" as "an entity with respect to which another person: (1) Directly or indirectly holds either: (i) A majority of the equity securities of such entity, or (ii) The right to receive upon dissolution of, or the contribution of, a majority of the capital of such entity; (2) Reports its financial statements on a consolidated basis under Generally Accepted Accounting Principles or International Financial Reporting Standards, and such consolidated financial statements include the financial results of such entity; and (3) Is required to aggregate the positions of such entity under § 150.4 and does not claim an exemption from aggregation for such entity.").

[62] Consistent with this clarification, for purposes of exchange-set position limits, the Commission should permit market participants to apply for and rely on *bona fide* hedging exemptions on an individual, non-consolidated basis.

[63] *See* CFTC Rule 1.3(z)(2)(iv); *see also Glossary*, CME GROUP, http://www.cmegroup.com/education/glossary.html (last visited Jan. 28, 2014) (glossary definition of "cross hedging").

Commission's Proposed Rule permits cross-commodity hedging based on a qualitative standard similar to its existing speculative position limits rule. However, for the first time, the Proposed Rule includes a rebuttable presumption that a hedge is not eligible as a cross-commodity hedge if it does not meet a quantitative factor.

1. The Commission Should Eliminate the Quantitative Factor

The proposed quantitative factor requires that the correlation 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) must be at least 0.80 for at least 36 months.[64] If a cross-commodity hedge does not meet this threshold, the Commission presumes that the hedge does not qualify as a *bona fide* hedge. Market participants then can apply to the Commission to rebut the presumption that the cross-commodity hedge should not qualify as a *bona fide* hedging position. Because a cross-commodity hedge that does not satisfy the quantitative factor does not qualify as a *bona fide* hedging position, the quantitative factor operates as a bright-line test that prevents market participants from relying on a hedge until the Commission responds to its application.[65] For the reasons discussed below, FIA requests that the Commission eliminate the proposed quantitative factor for determining whether a cross-commodity hedge qualifies as a *bona fide* hedging position.

a. The Commission Did Not Articulate a Reason to Depart from Its Existing Standard

The Commission did not articulate any rationale for departing from its existing qualitative standard for cross-commodity hedging positions. Nor did it explain why the quantitative factor is necessary to determine whether a cross-commodity hedging position qualifies as a *bona fide* hedging position. FIA submits that the existing qualitative standard provides the flexibility necessary to enable market participants to hedge the commercial risks associated with commodities based on an evaluation of current market factors, including among other factors, the liquidity of the hedging instrument.[66] In this regard, FIA notes that in the Commission's final rule implementing the "Volcker Rule," the CFTC, SEC, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency require a banking entity to consider correlation as part of its hedging strategy, but "does not require the banking entity to prove correlation mathematically or by other specific methods."[67] The Commission should apply the same approach to cross-commodity hedges in the Proposed Rule and remove the quantitative factor.

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64 Proposed Rule at 75717.

65 *Id.* at 75716-17.

66 *See* CFTC Rule 1.3(z)(2)(iv).

67 *See Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds*, 79 Fed. Reg. 5536, 5631 (Jan. 31, 2014).

Under the Proposed Rules, the Commission Staff can issue a special call to request additional information regarding a cross-commodity hedge if there is a concern that a particular hedge should not qualify as a *bona fide* hedging position under the qualitative standard.[68] This procedure does not impose a burden on market participants to file an application with the Commission for each cross-commodity hedge that does not satisfy the quantitative factor. Furthermore, the Commission Staff is not required to use significant resources to review and respond to applications by market participants seeking to rebut a presumption that a cross-commodity hedge does not qualify as a *bona fide* hedging position.

b. The Quantitative Factor Incorrectly Uses Spot Prices as the Sole Basis to Measure Correlation

The Commission's proposed quantitative factor inappropriately measures correlation only between the spot prices of the target commodity and the spot prices of the commodity underlying a derivative contract to determine whether a cross-commodity hedge meets the rebuttable presumption of a *bona fide* hedge. This is not the same analysis that market participants use to make commercial judgments about the appropriateness of cross-commodity hedges. In certain commodities, the correlation between the target commodity and the commodity derivative contract is higher farther out the forward price curve.

For example, market participants have used natural gas futures contracts for decades as a cross-commodity hedge of electricity price risk. Because liquidity in deferred month electricity futures contracts is low and the term of many cash-market electricity contracts is long-dated, market participants use long-dated listed and OTC natural gas derivatives contracts to hedge electricity price risk. Moreover, even though the correlation between spot electricity and spot natural gas prices may be below the Commission's proposed safe harbor level, the correlation between forward electricity and forward natural gas prices is high.[69] The Commission's hedging rules should be sufficiently flexible to enable market participants to enter into cross-commodity hedging transactions when there is a commercially reasonable correlation between the forward prices of related commodities, even if that correlation is substantiated in qualitative terms.

c. The Quantitative Factor Fails to Consider Seasonal Correlation Differences

The quantitative factor inappropriately measures correlation over a prior 36-month period. For certain commodities, the correlation between the target commodity and the commodity derivative contract is higher on a seasonal basis and may not be as high throughout the year. For example, there is a seasonal correlation between finished gasoline and reformulated blendstock for oxygenate blending (RBOB). Despite changes in the seasonal correlation between related commodities, market participants still should be able to rely on the

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[68] *See* Proposed Rule 150.4(h).

[69] If there is sufficient liquidity and if it is economically appropriate, they may convert their natural gas contract hedges to electricity contract hedges as the spot period approaches.

best cross-commodity hedges available, regardless of whether they satisfy a quantitative factor at all times. Otherwise, the Commission inappropriately will force market participants to choose either not to hedge risks that the CEA entitles them to hedge without regard to speculative position limits, or to manage physical commodity price risk within speculative position limits.

d. The Quantitative Factor Inappropriately Restricts the Ability of Market Participants to Hedge

For many target commodities, there is no derivatives contract available to use as a hedge or the available derivatives contract has insufficient liquidity to provide cost-effective hedges. In those circumstances, market participants evaluate alternative commodity derivative contracts with sufficient liquidity to serve as a suitable hedge of the target commodity. For example, because there is no jet fuel futures contract, market participants often hedge jet fuel exposure with the liquid NYMEX Heating Oil futures contract. In addition, as discussed above, due to limited liquidity in electricity futures contracts outside of the spot month, market participants often rely on the liquid Henry Hub Natural Gas Futures Contract to serve as a cross-commodity hedge of the exposure.

By imposing a correlation factor of 0.80 for cross-commodity hedging, the Commission will significantly restrict the availability of cross-commodity hedging where a liquid commodity derivative contract does not meet the quantitative test. In these circumstances, market participants would have to: (1) attempt to rebut the presumption that a position is not a *bona fide* cross-commodity hedging position, (2) rely on less liquid instruments to hedge, (3) keep their cross-commodity hedges below the speculative limit, or (4) refrain from hedging entirely. In all of these instances, the quantitative factor ultimately makes it more difficult for market participants to hedge the risk of changes in the value of a commodity that they are entitled to hedge under the CEA. Furthermore, the quantitative factor will constrain the ability of swap dealers to provide liquidity to commercial market participants to hedge bespoke risk if the swap dealer cannot lay off the risk of the bespoke swap with a liquid Referenced Contract. These restrictions on the ability to cross-commodity hedge may ultimately lead to higher commodity prices for consumers.

When promulgating position limits rules under CEA section 4a(a)(2), the Commission must, to the maximum extent practicable, ensure sufficient liquidity for *bona fide* hedgers.[70] FIA anticipates that the quantitative factor may fracture liquidity for certain highly liquid derivative contracts because market participants must identify alternative means to hedge cross-commodity exposure where a liquid derivative contract does not meet the quantitative factor. For example, the proposed quantitative factor may significantly reduce the liquidity of natural gas futures contracts because market participants would not be able to hedge the price risk of cash market electricity contracts with natural gas futures contracts. To maximize the liquidity available to *bona fide* hedgers, FIA requests that the Commission eliminate the quantitative factor for treating a cross-commodity hedging position as a *bona fide* hedging position.

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[70] *See* CEA section 4a(a)(3)(B)(iii).

One example of a common cross-commodity hedging strategy is hedging exposure to fuel oil with the NYMEX Light Sweet Crude Oil futures contract (CL). FIA members reviewed the proposed quantitative factor and found that the following, among other, common hedging strategies involving CL and fuel oil may not meet the quantitative:[71]

Crude Oil Cross-Commodity Hedges that do Not Meet the Proposed Quantitative Factor
Fuel Oil, 1% New York Harbor Cargoes
Fuel Oil, 1% NW Europe Cargoes CIF
Fuel Oil, 1% NW Europe Cargoes FOB
Fuel Oil, Singapore 180 CST
Fuel Oil, 3.5% Rotterdam (Barges, FOB Rott)
Fuel Oil, 1% New York Harbor Swaps
Fuel Oil, 1% NW Europe Cargoes CIF HI
Fuel Oil, 1% NW Europe Cargoes FOB HI
Fuel Oil, 3% Gulf Coast
Fuel Oil, Singapore 380 CST Cargoes

e. The Quantitative Factor Will Impose Significant and Unnecessary Burdens on Market Participants and the Commission

As proposed, the quantitative factor is a bright line test. If a cross-commodity hedge does not satisfy the quantitative factor, it does not qualify for the *bona fide* hedge safe harbor. Although a market participant can attempt to rebut the presumption that the cross-commodity hedge does not qualify as a *bona fide* hedge through an application under CFTC Rule 140.99, the proposed procedure imposes significant burdens on the Commission and market participants. Market participants will have to prepare and file the request for all hedges that do not meet the quantitative factor and Commission Staff will have to review each request. Given the likely large number of applications, many of which may be duplicative, and the Commission's limited resources, Staff are unlikely to be able to respond to requests in a timely manner. While their applications are pending, market participants will incur risks that they will only be able to hedge within speculative position limits. This is particularly ironic since a speculator is entitled to take speculative positions up to the same limit. If a commercial market participant's cash-market

[71] FIA understands that some commenters will be submitting to the Commission data which shows that many commonly used cross-commodity hedges, including some by *de minimis* amounts, will not satisfy the quantitative factor. Under the Proposed Rule, market participants thus will be forced to make scores of filings seeking to rebut the presumption that these common, commercially reasonable cross-commodity hedges, which indisputably reduce risk, are not *bona fide* hedging positions.

exposure exceeds the applicable limit, it will be forced to incur risks that it should be permitted to hedge.

Rather than imposing the constraints associated with a 140.99 application, the Commission should continue to allow market participants to determine the appropriateness of a cross-commodity hedge based on the market participants' analysis of the qualitative factor. If the Commission has concerns about a particular cross-commodity hedge, it can contact the individual market participant through its special call authority and request that the market participant provide additional detail regarding why the position should be treated as a cross-commodity hedging position.

2. The Commission Should Permit Market Participants to Maintain Cross-Commodity Hedges in the Spot Month

The Proposed Rule prohibits a market participant from relying on a *bona fide* hedge exemption if it maintains a physical-delivery Referenced Contract as a cross-commodity hedging position during the lesser of the last five days of trading or the spot period. This restriction significantly limits the ability of market participants to hedge physical commodity risk during the spot month. For example, as explained in the Working Group of Commercial Energy Firm's ("Working Group") January 20, 2012 petition to the CFTC ("Working Group Petition"), 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, even into the spot month, because there is no jet fuel futures contract.[72]

If the supplier cannot maintain its hedge into the spot month, its only alternatives would be not to hedge the cash position and incur risk, or to hedge the cash position with a physical-delivery Referenced Contract outside of the spot month, which represents a different delivery period. As a result, the Commission's restriction on cross-commodity hedging in the spot month will force market participants to incur additional risk or rely on an imperfect hedge, which leaves market participants with some un-hedged exposure. In addition, this restriction may fracture liquidity in physical-delivery Referenced Contracts as market participants seeking to hedge physical exposure shift to cash-settled Referenced Contracts to hedge exposure in the spot month.

D. The Commission Should Propose a Commercially Practical Process Through Which Market Participants Can Apply for a Non-Enumerated Hedge Exemption

Under the Proposed Rule, if the CFTC does not recognize a hedge position as an enumerated hedge, the position does not qualify as a *bona fide* hedging position. Market participants can petition the CFTC, pursuant to CEA section 4a(a)(7), to issue a rule, regulation or order, to expand the list of enumerated positions to include the position described in the

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[72] *See* Working Group Petition.

petition.[73] However, in contrast to the Commission's existing procedures for granting non-enumerated hedge exemptions, the exemption process in the Proposed Rule does not specify a timeframe within which the Commission must address a request. Currently, under CFTC Rule 1.47, the CFTC Staff have 30 days to respond to a new request for a non-enumerated hedge position or 10 days to respond to an amendment to an existing request.

As proposed, the petition process for recognizing a non-enumerated hedge is the same as the process for recognizing a non-enumerated hedge under the vacated Part 151 rule. During the past two years, filing petitions did not provide market participants with timely or even any responses to non-enumerated hedge requests. Because of the statutory prohibition against limits on *bona fide* hedging transactions, and the need to enable market participants to manage the risks they incur in their commercial operations, FIA recommends that the Commission continue to authorize non-enumerated hedging transactions through mechanisms like the ones in existing CFTC Rules 1.3(z)(3) and 1.47. The existing rules delegate the authority to grant non-enumerated hedge exemptions to CFTC Staff and provide specific timeframes for a response, both of which encourage timely responses to non-enumerated hedge filings.

FIA understands that Commission Staff have concerns about the lack of standards provided to evaluate non-enumerated hedge filings under current CFTC Rule 1.47 and the existing timeframes for Staff to review these filings. Rather than replacing the process in CFTC Rule 1.47, FIA recommends that the Commission modify the existing rules to provide additional standards for evaluating a request and expand the timeframes for Staff to respond to a request.

1. The Proposed Process for Recognizing Non-Enumerated Hedging Positions under CEA Section 4a(a)(7) Will Not Provide Market Participants with Responses in a Commercially Reasonable Time Period

During the implementation of the CFTC's Part 151 rule, the Commission did not address any of the three petitions asking it to expand the list of enumerated hedging transactions.[74] For example, the Commission did not respond to the Working Group's Petition filed on January 20, 2012 prior to the District Court vacating the Part 151 rule on September 28, 2012 – a period of eight months. Had the court not intervened, market participants may have been precluded from engaging in long-standing hedging practices that reduce risk. FIA anticipates that the need for timely responses will be even more important given that the Commission proposes to impose

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[73] Proposed Rule at 75718. The Proposed Rule also provides that market participants can file a request for an interpretation from Commission Staff under CFTC Rule 140.99 regarding whether a hedging position falls within the existing list of enumerated hedging positions. *See id.* at 75717.

[74] *See* Working Group Petition; Petition from Am. Petroleum Inst., to Commodity Futures Trading Comm'n (Mar. 13, 2012), *available at* http://www.cftc.gov/stellent/groups/public/@rulesandproducts/documents/ifdocs/apiltr031312.pdf; Petition from CME Grp., to Commodity Futures Trading Comm'n (Apr. 26, 2012), *available at* http://www.cftc.gov/stellent/groups/public/@rulesandproducts/documents/ifdocs/cmeltr042612.pdf; Petition from Commodity Mkts. Council, to Commodity Futures Trading Comm'n (Sept. 11, 2012), *available at* http://www.cftc.gov/stellent/groups/public/@rulesandproducts/documents/ifdocs/cmcpetition091112.pdf.

speculative position limits on swaps. Market participants often enter into swaps as bespoke hedging instruments, rather than futures contracts. Because the list of enumerated hedges is based on the futures markets, the enumerated hedging categories may not sufficiently cover swaps used to hedge commercial risk.

2. CFTC Staff Should Have the Authority to Approve Non-Enumerated Hedge Requests within Commercially Reasonable Time Periods

The current process for recognizing non-enumerated hedging transactions delegates the evaluation of non-enumerated hedge requests to Commission Staff and includes time periods within which the Staff must respond to the requests. Both of these features historically have promoted timely responses to non-enumerated hedge requests, which enables market participants to enter into important risk-management transactions as they incur commercial risks. FIA understands that CFTC Staff are concerned that current CFTC Rule 1.47 does not provide sufficient standards for Staff to consider whether a non-enumerated hedge position should qualify as a *bona fide* hedging position. FIA recommends that any regulation designed to recognize non-enumerated hedging positions require that the applicant demonstrate how the position meets the statutory definition of *bona fide* hedging transaction or position, as defined in CEA section 4a(c)(2). For example, the filing should demonstrate that the hedge meets the economically appropriate test, temporary substitute test, and incidental test described in the statute.

FIA also understands that CFTC Staff are concerned about the timeframes to review a non-enumerated hedge filing under current CFTC Rule 1.47, which provides a 30-day review period for initial filings and a 10-day review period for supplemental filings.[75] Rather than abandon the current process to recognize non-enumerated hedges due to concerns about the timing for review, the Commission should expand the review period deadlines to allow CFTC Staff the time needed to review a notice filing. FIA believes that a 45-day review period for initial filings and a 15-day review period for supplemental filings should be sufficient for Staff to review and determine whether the filing meets the statutory definition of a *bona fide* hedging position.

3. Non-Enumerated Hedge Exemptions Are Not Limited to Risk-Management Positions

Under the Proposed Rule, the Commission states that historically market participants relied on the non-enumerated hedging exemption "to offset the risk arising from swap books, which the Commission has addressed in the proposed pass-through swaps and pass-through swap offsets."[76] As a result, the Commission did not provide for a non-enumerated hedge exemption because it did not propose a risk-management exemption in the definition of *bona fide* hedging position for physical commodity contracts. Although the Proposed Rule does not provide a risk-

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75 *See* CFTC Rule 1.47(a)(1), (2).

76 Proposed Rule at 75718.

management exemption, the Commission should still view non-enumerated hedge exemptions as a necessary component of the definition of *bona fide* hedging position.

The fact that a limited number of market participants have relied on non-enumerated risk-management exemptions for the agricultural contracts subject to CFTC-set speculative position limits is not demonstrative of the need for market participants generally to rely on the exemption for other commodities. Under existing exchange rules, the definition of *bona fide* hedging position is not limited to enumerated hedge positions, so market participants did not need to request CFTC-granted non-enumerated hedge exemptions.[77] Instead, they have relied on the broader definition of *bona fide* hedging position in exchange rules or applied for exchange-granted risk-management exemptions. In addition, as described in section IX.H below, because the commercial need for risk-management exemptions continues, the Commission should permit Staff to grant risk-management exemptions.

E. The Commission Should Include the Transactions in the Working Group's Petition as Enumerated Hedging Positions

FIA continues to support the Working Group's Petition requesting that the Commission expand the list of enumerated hedging transactions to include ten examples of common risk-reducing transactions.[78] FIA details below its support for including the following transactions described in the Working Group's Petition as enumerated hedging transactions.

1. Working Group Request 3: Hedge of Anticipated Commitment to Buy or Sell

The third request in the Working Group Petition relates to Referenced Contracts used to lock in a price differential where one leg of the underlying transaction is an un-priced commitment to buy or sell and the offsetting sale is anticipated, but not yet completed. The Commission did not include this type of transaction as an enumerated hedge in its Proposed Rule. FIA supports including this type of hedge as an enumerated hedging transaction. The statutory definition of *bona fide* hedging position includes "assets that a person owns, produces, manufactures, processes, or ***merchandises***, or ***anticipates*** owning, producing, manufacturing, processing, or ***merchandising***."[79] The Commission does not have the discretion to eliminate anticipatory merchandising as a category of *bona fide* hedging positions.

FIA also notes that the Commission recognizes anticipatory hedging in the context of other rules. For example, in the Volcker Rule, the Commission's final rule implementing prohibitions and restrictions on the ability of a banking entity and nonbank financial company to engage in proprietary trading, the Commission permits the trading desk to:

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77 *See, e.g.*, CME Rule 559.A; IFUS Rule 6.26(a).

78 *See* Working Group Petition.

79 *See* CEA section 4a(c)(2)(A)(iii)(I) (emphasis added).

> establish an anticipatory hedge position before it becomes exposed to a risk that it is highly likely to become exposed to, provided there is a sound risk management rationale for establishing such an anticipatory hedge position . . . . The amount of time that an anticipatory hedge may precede the establishment of the position to be hedged will depend on market factors, such as the liquidity of the hedging position.[80]

Because the Commission recognizes anticipatory hedging for banks and nonbank financial companies supervised by the Board of Governors of the Federal Reserve, the Commission similarly should recognize anticipatory hedging when entities, including marketers, hedge anticipated purchases or sales of a physical commodity.

Additionally, as a policy matter, the failure to allow for hedging of anticipatory merchandizing transactions may have the unintended consequence of causing market participants to make decisions that will introduce greater credit risk than necessary. One possible result of excluding hedges of anticipatory merchandizing transactions will be that market participants will enter into more fixed-price contracts to buy and sell a commodity rather than un-priced commitments. Long-term fixed-price contracts expose parties to more credit risk (the risk of default by either counterparty) as the market price moves away from the fixed price. Un-priced commitments to buy or sell a commodity, such as a contract to sell at an index, pose less credit risk to the parties. It is contrary to sound public policy to adopt a rule that promotes hedging strategies that unnecessarily introduce more credit risk into the system than would have otherwise existed if the Commission permitted the hedging of anticipatory merchandizing transactions as specifically authorized by CEA section 4a(c)(2).

2. Working Group Request 4: Hedges of Irrevocable Fixed-Price Bids or Offers

The fourth request in the Working Group Petition addresses hedges of market price volatility associated with binding and irrevocable fixed-price bids or offers. The CFTC did not include this type of transaction as an enumerated hedge in its Proposed Rule. FIA submits that binding and irrevocable bids create real and immediate risk of acceptance of an offer and thus necessitate hedging of that risk. If the Commission does not permit market participants to hedge this type of exposure, fewer market participants will be willing to submit competitive bids or offers. This reduced competition is likely to lead to increased costs for commercial and other end users of commodities because the price of irrevocable bids and offers will have to increase to reflect the un-hedged price risk. To the extent the Commission is concerned about a market participant relying on a *bona fide* hedging exemption for irrevocable fixed-price bids or offers after the market participant did not win the bid or offer, the CFTC could condition the exemption

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[80] *Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds*, 79 Fed. Reg. at 5614.

on a market participant exiting a *bona fide* hedging position within a commercially reasonable period of time after losing a bid or offer.

3. Working Group Request 7: Hedging Calendar Month Average Contracts

The Working Group's seventh request (as supplemented with respect to Scenario 2) represents circumstances where energy market participants use a pricing convention known as calendar month average ("CMA") pricing. FIA understands that many producers and refiners prefer a CMA price to buy and sell a physical product such as crude oil. This pricing convention allows the parties to a CMA contract to convert and hedge their pricing from a "futures contract month" to a calendar month, *i.e.*, a futures contract month reflecting those days on which deliveries take place during the delivery month (*e.g.*, for the NYMEX WTI Crude Oil contract, deliveries take place from the first day of the delivery month until the last calendar day of the delivery month). Commodity derivative contracts that hedge or lock-in the sale of crude oil or other products at CMA prices are not speculative. FIA supports the Working Group's request to treat these positions as *bona fide* hedge positions.

4. Working Group Request 8: Physical-Delivery Bona Fide Hedging Positions Held During the Spot Month

The Working Group's eighth request asserts that all physical-delivery Referenced Contracts in energy should be permitted as *bona fide* hedging positions in the spot month. The Proposed Rule applies the same restrictions that were imposed under the 2011 Position Limits Rule, with a change in the application of the unfilled anticipated requirements. FIA members support the inclusion of all physical-delivery Referenced Contracts as *bona fide* hedging positions during the spot month.

5. Working Group Request 9: Cross-Commodity Hedges with Physical-Delivery Referenced Contracts in the Spot Month

The Working Group's ninth request states that physical-delivery Referenced Contracts that serve as cross-commodity hedges should be allowed into the spot month. The CFTC declined to permit this request in the Proposed Rule. For the reasons discussed in section IX.C.2 above, FIA members support extending the definition of *bona fide* hedging position to include physical-delivery Referenced Contracts held during the spot month to cross-commodity hedge commercial risk.

F. Referenced Contracts Used to Hedge the Risks Associated with Unfilled Storage Capacity Should Be Included in the List of Enumerated Hedging Positions

The CFTC declined to re-propose a *bona fide* hedge exemption for unfilled storage capacity, which the CFTC permitted in the Part 151 speculative position limits rule.[81] The CFTC

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[81] *See* Former CFTC Rule 151.5(a)(2)(v).

should include unfilled storage capacity as an enumerated hedging position. As noted in section IX.E.1 above, the statutory definition of *bona fide* hedging position includes anticipatory merchandising, so the Commission should recognize this type of hedging position.

In the preamble to the Proposed Rule, the Commission states that "the value fluctuations in a calendar month spread in a commodity derivative contract will likely have at best a low correlation with value fluctuations in expected returns (*e.g.*, rents) on unfilled storage capacity."[82] FIA submits that storage has value beyond the rents collected in connection with the storage. For example, if a market participant holds storage and the market for the commodity is in contango, market participants can enter a calendar spread to lock in the value of the storage. In addition, the Federal Energy Regulatory Commission's ("FERC") regulations require that pipelines allow market participants to release storage capacity to third parties subject to certain conditions.[83] This right is a valuable asset that market participants should be allowed to protect through *bona fide* hedging positions.

G. The Commission Should Interpret the Orderly Trading Requirement Consistently with Its Disruptive Trading Practices Guidance

As is true under current Rule 1.3(z), the Commission's proposed definition of *bona fide* hedging position provides that the hedge positions must be "established and liquidated in an orderly manner in accordance with sound commercial practices."[84] However, for the first time, the CFTC proposes to impose a duty of "ordinary care" on *bona fide* hedgers when entering and exiting the market. Therefore, under the Proposed Rule, "negligent" trading would be a sufficient basis for the Commission subsequently to disallow a *bona fide* hedging exemption. The Commission also explains that it intends to apply its policy regarding orderly markets for purposes of disruptive trading practices to its orderly trading requirement for speculative position limits.[85]

FIA requests that the Commission clarify or modify the following, among other, aspects of the orderly trading requirement:

- The Commission should clarify which Division of the CFTC will determine whether a hedger has established and liquidated hedging positions in an orderly manner.
- The Commission should modify the requirement so that if it disallows a *bona fide* hedge exemption due to the orderly trading requirement, then it will only disallow the particular exemption to which the trading relates and not disallow *bona fide* hedge exemptions for all trading.

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[82] Proposed Rule at 75718.

[83] *See* 18 C.F.R. 284 (2013).

[84] Proposed Rule 150.1.

[85] *See Antidisruptive Practices Authority*, 78 Fed. Reg. 31890 (May 28, 2013).

- The CFTC should apply the orderly trading requirement consistently with the exchanges' orderly trading requirement, which takes into consideration characteristics of the market for which the exemption is sought.[86]

The proposed standard of care for disallowing treatment of a position as a *bona fide* hedging position under the proposed speculative position limits orderly trading requirement is lower than the standard used to establish liability under the Disruptive Trading Practices Policy Statement.[87] In the Policy Statement, the Commission states that it only intends to exercise its authority to impose liability under section 4c(a)(5)(B) for intentional or reckless conduct. In particular, the guidance provides "that accidental, or even negligent, trading, practices, or conduct will not be a sufficient basis for the Commission to claim a violation . . . ."[88] At a minimum, the Commission should apply the same standard for disallowing treatment of a position as a *bona fide* hedging position for purposes of the orderly trading requirement as it will apply under the disruptive trading practices rule. Applying a higher standard is very important because the Commission necessarily will be examining the establishment and liquidation of positions after-the-fact, rather than from the perspective of a market participant that is attempting to manage significant commercial risks in what may be rapidly changing market conditions. Applying a "reasonable person" standard to risk-management activity tailored to a company's unique risk-management profile may have an inappropriate chilling effect on important risk-management activity. Indeed, even applying a recklessness standard will raise significant compliance and enforcement uncertainty because of the difficulties of applying a market-wide standard to trading that is focused on the unique risk-management needs of a specific market participant.

H. The Commission Should Continue to Grant Risk-Management Exemptions for Non-Speculative Positions

The Commission did not propose a risk-management exemption within the definition of *bona fide* hedging position for physical commodities. As FIA has commented in the past, the CFTC should define *bona fide* hedging transactions and positions more broadly so that the definition will encompass long-standing and important commercial risk-management practices.[89] Exemptions from speculative position limits should be available for positions that serve the same function as *bona fide* hedging positions – *i.e.*, they manage risk and, therefore, promote financial stability. Because risk-management positions do not constitute speculative activity, they should not be subject to speculative position limits.

As discussed in the preamble to the Proposed Rule, the Commission historically has permitted risk-management exemptions for market participants to hedge exposure to commodity

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86 *See, e.g.*, CME Rule 559; *see also* CME GROUP, *Market Regulation Advisory RA0909-5* (Sept. 14, 2009), http://www.cmegroup.com/rulebook/files/CME_Group_RA0909-5.pdf.

87 *Antidisruptive Practices Authority*, 78 Fed. Reg. at 31895.

88 *Id.*

89 *See* FIA March 2011 Letter.

index contracts.[90] Risk-management exemptions allow swap dealers to provide market participants with access to commodity index contracts. For example, as discussed in detail above, pension funds and endowments often rely on commodity index contracts to hedge against inflation risk. By restricting the ability of swap dealers to hedge their exposure to commodity index contracts, the Commission will reduce the liquidity of Referenced Contracts for other market participants.

I. The Commission Should Affirm that Aggregation Pursuant to an Express or Implied Agreement Is Only Required When the Parties Agree to Trade Referenced Contracts Pursuant to Such an Agreement

As FIA explains in its comment letter on the Proposed Aggregation Rule, FIA is concerned about the Commission's analysis of its aggregation rules in Example No. 7 of proposed Appendix C. FIA hereby incorporates those comments in this comment letter by reference.

X. The Commission Should Modify the Position Limits Reporting Requirements to Make Them Commercially Practicable

FIA appreciates the opportunity to comment on the forms published by the Commission in connection with the Proposed Rule.[91] FIA's members have reviewed the proposed forms and provide the Commission with the recommendations described below to make the forms more practical and reasonable, and to facilitate the reporting of accurate data.

FIA members are concerned that the Commission significantly underestimates the costs associated with reporting under the Proposed Rule.[92] For example, the Commission estimated that Form 204 would take approximately two hours per response to complete, resulting in "an annual per-entity cost of approximately $2,900."[93] Furthermore, the Commission estimated that Form 704 would take approximately twenty hours per response to complete, resulting in "an annual per-entity cost of approximately $24,000."[94] The Commission's total estimated cost per-entity, per-year, for all forms amounts to $80,000.[95]

The Commission's analysis fails to take into account several key tasks that will have to be completed in order for market participants to correctly file the forms requested. For example, the Commission's cost estimates do not include the substantial costs associated with developing

[90] Proposed Rule at 75740-41.

[91] Under vacated Part 151, the Commission did not propose the various position-limits forms for public comment. Because the reports sought data in ways that did not match their commercial operations, FIA members encountered significant difficulty in attempting to complete the forms.

[92] *See generally* Proposed Rule at 75777-80.

[93] *See id.* at 75779-80.

[94] *See id.* at 75780.

[95] *See id.* at 75779-80.

systems necessary to identify, collect, generate, and verify data. Market participants will need to invest a significant amount of time and capital in systems that will enable them to make these position-limits filings. In addition, market participants will incur significant non-labor storage costs associated with maintaining records necessary to complete these new forms.[96] FIA preliminarily estimates that the start-up costs to develop information technology systems necessary to track and report positions across multiple deal capture systems will vary among members, but will range from approximately $750,000 to $1,500,000 per firm. Furthermore, FIA anticipates significant ongoing costs associated with filing the proposed position limit forms that far exceeds the Commission's estimate of $80,000 per entity per year. FIA members estimate that their ongoing annual costs will vary among members, but will range from approximately $100,000-$550,000 per entity per year. These ongoing costs are in addition to the estimated start-up costs.

FIA makes the following recommendations to make more practical, and reduce the costs associated with, the proposed reporting requirements and, at the same time, to provide the Commission with more useful information.

A. The Commission Should Not Require Next-Day Reporting

Under the Proposed Rule, market participants must file: (i) Form 504 to rely on the conditional limit for natural gas (and other commodities potentially added in the future) and (ii) Form 604 for pass-through swap offsets during the spot month, by 9:00 am the next business day after the reporting requirement is triggered.[97] The Commission should not require market participants to file *any* position-limits forms within one day of triggering a reporting requirement. Market participants need time to: (i) generate and collect the data needed to complete the report and (ii) verify the accuracy of the reported data once compiled. The proposed next-day filing requirements do not provide market participants with sufficient time to perform these tasks, which are *necessary* to ensure the accuracy of the data submitted to the CFTC.

Moreover, the CFTC did not explain why it needs the data on Form 504 or Form 604 on a next-day basis, rather than within a time period that would provide sufficient time to collect, collate, and submit accurate data. The data associated with general cash-market positions in the case of Form 504 and *bona fide* hedges in the case of Form 604 provide the Commission with data similar to the *bona fide* hedges detailed on Form 204, which the Commission proposes to collect on a monthly basis. Logically, Form 504 and Form 604 should be collected on a monthly basis as well.

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[96] *Cf. Commission Information Collection Activities (FERC-555); Comment Request*, 78 Fed. Reg. 77111, 77112 (Dec. 20, 2013) (FERC analyzed non-labor record storage costs associated with maintaining records necessary to complete various reports to FERC).

[97] *See* Proposed Rule 19.01(b).

As noted in section IV.C, FIA requests that the Commission eliminate the conditions associated with higher limits for cash-settled contracts, including the requirement to file Form 504. To the extent that the Commission imposes a filing requirement associated with higher limits for cash-settled contracts in the spot month, the filing requirement should follow the same requirements as the other position-limits forms. That is, if market participants rely on higher limits for cash-settled contracts, they should file a Form 504 at the end of the month.

The Commission also should provide market participants with the flexibility to file Form 504 in a manner similar to the approach used by IFUS for natural gas contracts. The IFUS filing is due in advance of claiming higher limits for cash-settled contracts and describes a market participant's cash-market positions as of a specified date in advance of the spot month.[98]

B. Forms 204 and 604 Should Not Require Market Participants to Report Futures-Equivalent Positions

As proposed, Form 204 and Form 604 (as it applies to a pass-through swap with a non-referenced contract swap offset) require monthly reporting of cash-market and futures-equivalent derivative positions as of the last Friday of the month.[99] FIA requests that the Commission remove the requirement that market participants report futures-equivalent positions. On the Commission's existing Form 204, for contracts subject to CFTC-set limits on Legacy Agricultural Contracts, market participants submit cash-market positions in various grains (*e.g.*, soybeans, corn, wheat), but do not report their futures or futures-equivalent positions. The Commission did not explain why it needs to change course and obtain data on a market participant's futures-equivalent positions as part of proposed Form 204. Presumably, the Commission already has a market participant's futures-equivalent position from the Commission's various large-trader reporting rules and access to SDR data, if needed.[100]

A market participant's cash positions reported on forms 204 and 604 along with the Commission's existing position data should provide the Commission with sufficient data to monitor compliance with position limits. Thus, FIA requests that the Commission retain the reporting structure of current Form 204 and only require market participants to report cash-market positions, not futures-equivalent positions.[101]

Furthermore, FIA notes that, for certain Referenced Contracts, the prompt month contract *will no longer trade* as of the last Friday of the month. Thus, market participants will not be reporting any prompt month positions that would have been subject to a spot month limit. For

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[98] *See Conditional Limit Form for Significant Price Discovery Contracts*, ICE U.S. OTC COMMODITY MARKETS, LLC. (ICE), https://www.theice.com/publicdocs/otc/advisory_notices/ICE%20Conditional%20Limit%20Form.doc (last visited Jan. 28, 2013).

[99] Proposed Rule 19.01(b)(1).

[100] *See* 17 C.F.R. pts. 15, 16, 17, 18, 20.

[101] As noted above in section IX.B, the Commission should continue to permit legal entities within an aggregated group to apply for and rely on separate *bona fide* hedging exemptions, rather than requiring them to apply for and manage *bona fide* hedging exemptions on an aggregated basis.

example, the last trading days of the NYMEX Henry Hub Natural Gas (NG) and the Light Sweet Crude Oil (CL) prompt month contracts are before the last Friday of the month.[102] In addition, for certain energy commodities such as CL, the final calendar month for the prompt month contract will not have commenced as of the last Friday of the month. In other words, if a market participant exceeds a spot month position limit, it will report its cash positions as of the last Friday of the month, but will not have any spot-month positions to report. For this additional reason, FIA recommends that the Commission remove the requirement to report futures-equivalent positions for Referenced Contracts on proposed Forms 204 and 604.

C. The Commission Should Modify the Proposed Reporting Forms

1. Form 204

To the extent the Commission includes futures-equivalent positions on Form 204, column three requests data regarding the "commodity derivative contract (CDC) or Referenced Contract (RC) used for hedging."[103] The Commission has not explained why a market participant should report commodity derivative contracts that are not Referenced Contracts. FIA recommends that the CFTC eliminate the reference to CDCs.

Furthermore, the Commission should clarify in column three that market participants can list all Referenced Contracts in a single line item. The form should not require market participants to identify the number of futures-equivalent Referenced Contracts that hedge an identified amount of cash-market positions separately for each Referenced Contract. That is a time consuming process that would add to the financial burden placed on market participants in completing this form without any added benefit to the Commission.

Lastly, because a market participant triggers a Form 204 (or Form 604) filing requirement when it exceeds an applicable position limit, the Commission should clarify that the reports on Form 204 (or Form 604) should only relate to *bona fide* hedging positions for that particular limit. For example, if a market participant exceeds a spot month limit, it should only report underlying cash-market activity related to that particular spot month. The Commission should not require a market participant to file reports related to non-spot month positions where the market participant did not exceed a non-spot month position limit. Absent such a clarification, the scope of the reporting obligations associated with the position limits forms, and the burdens associated with those reporting obligations, increase significantly. The increased burdens do not provide the Commission with a monitoring benefit because the market participant did not exceed the relevant spot month or non-spot month limits.

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[102] *See* NYMEX Rule 200102.F.

[103] Proposed Rule at 75793.

2. Form 704

Column five of Form 704 requests the "Cash commodity same as (S) or cross-hedged (C-H) with Core Reference Futures Contract (CRFC)."[104] This column suggests that market participants should respond with an "S" where the cash commodity is the same as the CRFC and a "C-H" where the cash-commodity is a cross-hedge. However, the sample Form 704 lists "CL-NYMEX" as the information reported in this column.[105] The CFTC should clarify how to complete this form.

In addition, column six requests data regarding a market participant's "Annual Production, Requirements, Royalty Receipts, Service Contract Payments or Receipts for Preceding Three Years."[106] However, the form does not provide guidance as to how a market participant should complete this field if the market participant does not have three years of data related to the anticipatory hedge. For example, a market participant may seek to hedge the anticipated production of a newly developed well, but the participant will not have three years of prior anticipated production to complete the form. The CFTC should permit a market participant to provide a reasonable estimation of anticipated production (or other anticipatory hedges, as applicable) based on commercial market experience.

XI. The Commission Should Modify Its Proposed Rules Applicable to DCM and SEF Position Limits

The Proposed Rule imposes obligations to set speculative position limits, or accountability levels in lieu of speculative position limits, at the exchange level.[107] As a general matter, the Commission should provide additional flexibility to exchanges to impose and administer speculative position limits or position accountability levels based on the exchanges' evaluation of whether speculative position limits are necessary or appropriate.

A. Contracts Subject to Federal Speculative Limits

Under the Proposed Rule, if the Commission adopts federal speculative position limits, DCMs and SEFs are required to establish speculative position limits no higher than the federal speculative limits.[108]

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[104] *Id.* at 75818. FIA also requests that the Commission clarify the number of columns on final Form 704. Currently, the proposed Form 704 contains eleven columns, including a column for "Core Referenced Futures contract (CRFC)," while the examples of Form 704 contain only ten columns because there is no column for "Core Referenced Futures contract (CRFC)." *See id.* at 75818-22.

[105] *Id.* at 75821.

[106] *Id.* at 75818.

[107] Proposed Rule 150.5.

[108] Proposed Rule 150.5(a)(1).

1. The Commission Should Not Require Market Participants to Apply for an Inter-Market Spread Exemption

The Proposed Rule authorizes DCMs and SEFs to grant an "inter-market spread exemption" for contracts subject to CFTC-set limits.[109] This provision permits exchanges to allow a market participant to net Referenced Contract positions across exchanges and OTC positions.[110] In contrast to the federal limits, market participants must apply to the exchange to net Referenced Contracts.[111] Any requirement to apply for an exemption in advance of exceeding an exchange-set non-spot month limit imposes a significant burden on market participants and limits the benefit of netting for purposes of any federal limits. Rather than require applications in advance, the Commission should authorize the exchanges to request information from a market participant to demonstrate that it is holding offsetting positions. Furthermore, this report should confirm a market participant's actual position toward a particular exchange limit and should not require exchange approval to net positions across exchanges and OTC.

A reporting process, as opposed to an exemption process, reduces the number of exchange filings and also helps prevent the risk that an exchange's decision about whether to grant, and the scope of, an exemption may be affected by competitive considerations between and among DCMs and SEFs. The recommended reporting process would decrease the burden on market participants to rely on the benefits of netting for purposes of the federal limits, but also provides a mechanism for the exchanges to understand a market participant's overall position. At most, and consistent with current exchange rules, the Commission should only require an application for an exemption to net positions for purposes of a spot month limit, and permit exchanges to issue a request for information if a market participant exceeds an exchange-set accountability level or position limit.[112]

2. The Commission Should Not Require Market Participants to Apply for an Intra-Market Spread Exemption

The Proposed Rule authorizes DCMs and SEFs to grant an "intra-market spread exemption."[113] This provision permits exchanges to provide an exemption from a single month position limit up to the level of the all-months-combined position limit.[114] Similar to inter-market spread exemptions, in the intra-market context, market participants must apply to the

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[109] Proposed Rule 150.5(a)(2)(ii)(B).

[110] Proposed Rules 150.1, 150.5(a)(2)(ii)(B).

[111] Proposed Rule 150.5(a)(3).

[112] *See* CME Rule 559; *see also* IFUS Rule 6.20. As noted in section XI.D below, FIA recommends that the Commission authorize the exchanges to impose position accountability levels in lieu of hard non-spot month limits.

[113] Proposed Rule 150.5(a)(2)(ii)(A).

[114] Proposed Rules 150.1, 150.5(a)(2)(ii)(A).

exchange in order to qualify for this exemption.[115] As suggested above, rather than requiring market participants to apply for an intra-market spread exemption, the CFTC should permit exchanges to make a special call in the event a market participant exceeds a single month limit, but is below the all-months-combined limit.

B. The Commission's Proposed Treatment of Anticipatory Hedging Positions Effectively Will Decrease the Size of Exchange-Set Speculative Position Limits

As discussed in section IX above, the Commission's narrow interpretation of *bona fide* hedging positions will adversely affect a market participant's ability to use commodity derivative contracts to hedge commercial risk. In particular, the Commission's proposed restrictions on anticipatory hedging in the spot month and its inappropriate failure to include anticipatory merchandising as an enumerated hedging transaction will force a market participant to hedge those risks within the federal and any exchange-set speculative position limits. These restrictions effectively will result in a decrease in the speculative positions available under exchange-set limits because hedging positions will count against a market participant's speculative position limit. By limiting the size of legitimate hedging positions that market participants can hold, the Commission's proposed restrictions will reduce market liquidity for *bona fide* hedgers, contrary to the statutory injunction in CEA section 4a(a)(3)(B).

C. The Commission Should Clarify that Basis Contracts Are Excluded from Exchange-Set Position Limits

The Proposed Rule excludes basis contracts from the definition of Referenced Contract.[116] As a result, basis contracts are not subject to the proposed federal limits. However, it does not appear that the CFTC proposes a similar exclusion for purposes of exchange-set limits. The Commission should clarify that basis contracts are excluded from exchange-set limits in order to provide for consistency between the rules for federal limits compared to exchange-set limits.

D. The Exchanges Should Have the Authority to Establish Position Accountability Levels in Lieu of Hard Speculative Position Limits

Consistent with FIA's comment regarding accountability levels outside of the spot month, as discussed in section IV.D.1 above, the CFTC should authorize exchanges to adopt accountability levels outside of the spot month for all exchange contracts.

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[115] Proposed Rule 150.5(a)(3).

[116] Proposed Rule 150.1.

E. SEFs Should Not Be Required to Establish Exchange Limits or to Monitor Compliance with Federal Limits

Under the Proposed Rule, SEFs are required to establish exchange-set spot month and non-spot month speculative position limits for contracts subject to federal limits.[117] In the preamble to the Proposed Rule, the Commission requests comments regarding whether it should exercise its exemptive authority under CEA section 4a(a)(7) to exempt SEFs from this requirement.[118] FIA requests that the Commission exempt SEFs from a requirement to enforce a market participant's compliance with federal limits through issuance of inter-market spread exemptions and eliminate the requirement for SEFs to establish exchange-set limits for contracts subject to federal limits.

Unlike DCMs, SEFs may utilize more than one derivatives clearing organization and provide for the execution of uncleared transactions. In addition, SEFs only provide facilities for the execution of swap transactions. Once those transactions are executed, SEFs have no information about the resulting positions because they are maintained by market participants away from the SEF environment. As a result, a SEF will not have information about whether the swap is terminated by agreement between the parties or offset in the OTC market. Given this complexity, a SEF is not suited to evaluate a market participant's overall position toward a federal limit and the Commission should not place a requirement on a SEF to issue an inter-market spread exemption or otherwise enforce compliance with federal limits.

As an execution facility that does not know position information, it is unclear how a SEF would monitor or apply position limits on its facility. Therefore, the Commission should not require SEFs to establish SEF speculative position limits for contracts subject to federal limits. FIA further submits that CEA section 5h(f)(6)(B) does not require SEFs to establish exchange-set speculative position limits where the Commission imposes federal limits. CEA section 5h(f)(6)(B)(ii) states that a SEF must "monitor" positions executed on the SEF for compliance with federal limits and the limit, "if any, set by the swap execution facility." The "if any" language implies that there may be circumstances where a SEF does not establish limits, but the Commission imposes federal limits. As a result, it appears that the CEA does not require SEFs to impose exchange-set speculative position limits where the Commission imposes federal limits.[119]

Given that the Commission recently finalized the SEF registration rule and the market for products traded on SEFs is still in the early stages of development, FIA requests that the Commission exempt SEFs from any requirement to establish SEF specific limits or enforce compliance with federal limits. In the alternative, if the Commission imposes a regulatory obligation on SEFs for contracts subject to federal limits, the Commission should limit the

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117 Proposed Rule 150.5(a).

118 Proposed Rule at 75755.

119 *See* CFTC Rule 37.600(b), which adopts regulations implementing CEA section 5h(f)(6)(B) and relies on the same statutory language as CEA section 5h(f)(6)(B).

obligation of the SEF to assisting the Commission in monitoring federal limits. The SEF could provide the Commission with data regarding transactions executed on its facility, or any additional data, as needed by the Commission.

XII. The Definition of Eligible Affiliate Should Include Sister Companies

The Commission defines an eligible affiliate in the Proposed Rule as an entity with respect to which another person:

> (1) Directly or indirectly holds either: (i) A majority of the equity securities of such entity, or (ii) The right to receive upon dissolution of, or the contribution of, a majority of the capital of such entity;
>
> (2) Reports its financial statements on a consolidated basis under Generally Accepted Accounting Principles or International Financial Reporting Standards, and such consolidated financial statements include the financial results of such entity; *and*
>
> (3) Is required to aggregate the positions of such entity under § 150.4 and does not claim an exemption from aggregation for such entity.[120]

If an entity qualifies as an "eligible affiliate" of another person, then the eligible affiliate is not required to comply separately with speculative position limits. In the preamble to the Proposed Rule, the Commission notes that the proposed definition of eligible affiliate is similar to the definition of "eligible affiliate counterparty" for purposes of the inter-affiliate exception to the mandatory clearing requirement under CFTC Rule 50.52.[121] The Commission also requests comment on the proposed definition of eligible affiliate and whether the definition should more closely track the definition of "eligible affiliate counterparty" in CFTC Rule 50.52.

FIA recommends that the Commission define eligible affiliate consistently with the definition of eligible affiliate counterparty under CFTC Rule 50.52. The proposed definition of eligible affiliate does not appear to cover sister affiliates in a corporate group because neither affiliate holds an ownership interest in the other. In contrast, the definition of eligible affiliate counterparty in CFTC Rule 50.52 expressly includes sister affiliates because the definition applies to entities that share a common owner.[122]

FIA understands that the purpose of the exemption for an eligible affiliate is to treat entities that are subject to the aggregation requirements as a single entity for position-limits purposes. To the extent the exemption only applies to subsidiaries and does not apply to sister affiliates, the Commission's speculative position limits rules will not treat aggregated entities as a single person because sister affiliates will separately need to comply with speculative position

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[120] Proposed Rule 150.1 (emphasis added).

[121] Proposed Rule at 75698.

[122] *See* CFTC Rule 50.52(a)(1)(ii).

limits. FIA does not believe that the Commission intended for sister affiliates to separately comply with speculative position limits, and thus recommends that the Commission define "eligible affiliate" consistent with the definition of "eligible affiliate counterparty" in CFTC Rule 50.52 for purposes of the definition of eligible affiliate for position limits purposes.

XIII. The Commission Should Provide Market Participants with an Extended Period after the Adoption of Any Final Rule to Comply with Speculative Position Limits

Based on the experience of FIA members in attempting to implement the prior Part 151 speculative position limits rule, FIA recommends that the Commission provide for an extended transition period of not less than nine months to comply with any final speculative position limits rule. To the extent the Commission does not have a complete set of data to estimate open interest for the entire market, the Commission should adopt a staggered compliance schedule for non-spot month speculative position limits for some time after the nine-month transition period.[123]

Previously, the Commission published the Part 151 final rule in the Federal Register on November 18, 2011, but the compliance date for speculative spot month position limits was 60 days after the Commission published the further definition of "swap" in the Federal Register. Because the Commission published the further definition of "swap" in the Federal Register on August 13, 2012, the compliance date for the Part 151 speculative spot month position limits rule was October 12, 2012.

Notwithstanding best efforts to prepare for positions limits, FIA members experienced significant difficulties understanding various aspects of the rules, including issues such as: (i) identifying contracts subject to limits, (ii) identifying entities subject to aggregation, (iii) identifying positions eligible as *bona fide* hedging positions, and (iv) establishing systems to prepare and file reports with the Commission. FIA expects the same issues to arise after finalization of the Proposed Rule.

FIA notes that, because the Proposed Rule is connected to other Commission rules, market participants need additional time to evaluate the inter-connection between speculative position limits and these other rules. For example, Commission rules require swap dealers to establish policies and procedures that are reasonably designed to monitor for and prevent violations of applicable limits by the Commission, a DCM, or a SEF.[124] If finalized as is, the Proposed Rule would significantly expand the scope of products subject to speculative position limits and significantly amend the definition of *bona fide* hedging position and the aggregation

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[123] As FIA noted earlier, under vacated Part 151, the compliance date for non-spot month speculative position limits did not commence until three months after the Commission posted non-spot month limits to its website, calculated based on 12 months of open interest data for the entire market.

[124] *See* CFTC Rule 23.601; *see also Swap Dealer and Major Swap Participant Recordkeeping, Reporting, and Duties Rules; Futures Commission Merchant and Introducing Broker Conflicts of Interest Rules; and Chief Compliance Officer Rules for Swap Dealers, Major Swap Participants, and Futures Commission Merchants*, 77 Fed. Reg. 20128 (Apr. 3, 2012).

standards associated with speculative position limits. Swap dealers will need time to evaluate the final rule and implement policies and procedures that are reasonably designed to prevent violations of speculative position limits. Market participants will also need time to evaluate the impact of speculative position limits on other rules, such as the ownership and control reports,[125] swaps large-trader reporting,[126] and recordkeeping requirements.[127]

Furthermore, FIA members and other market participants cannot commence preparation for any speculative position limits rule until the Commission finalizes the Proposed Rule. Since January of 2010, the Commission has issued four proposed rules and one interim final rule.[128] When comparing the various Commission and Staff documents related to speculative position limits, the Commission typically makes material modifications to the proposed rule before it becomes final and even *after* the rule becomes final. As a result, FIA members face significant uncertainty that the Proposed Rule will be substantially similar to a potential final rule. Thus, FIA members cannot begin to implement systems until after the Commission publishes a final rule.

Based on the foregoing, FIA members request that the Commission establish an extended transition period to comply with a final speculative position limits rule of nine months after any final rule is published in the Federal Register.

XIV. Conclusion

For the foregoing reasons, FIA respectfully requests that the Commission withdraw the Proposed Rule until after it has made a quantitative finding that speculative position limits are necessary, that limit levels are appropriate, and that positions above any proposed limits constitute excessive speculation. In the alternative, FIA requests that the Commission adopt FIA's recommended revisions to the Proposed Rule before issuing final position limit regulations. Please contact Barbara Wierzynski, Executive Vice President and General Counsel, or Allison Lurton, Senior Vice President and Deputy General Counsel, at 202-466-5460, if you have any questions about FIA's comments or recommendations.

Respectfully submitted,

Walt L. Lukken

Walter L. Lukken
President and Chief Executive Officer

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125 *See Ownership and Control Reports, Forms 102/102S. 40/40S, and 71*, 78 Fed. Reg. 69178 (Nov. 18, 2013).

126 *See Large Trader Reporting for Physical Commodity Swaps*, 76 Fed. Reg. 43851 (Jul. 22, 2011).

127 *See* CFTC Rule 45.2; *see also* CFTC Rules 23.201 – 23.203.

128 *See Federal Speculative Position Limits for Referenced Energy Contracts and Associated Regulations*, 75 Fed. Reg. 4144 (Jan. 26, 2010) (Energy Position Limits Proposed Rule); *see also* 2011 Proposed Rule; *Aggregation, Position Limits for Futures and Swaps*, 77 Fed. Reg. 31767 (May 30, 2012); 2011 Position Limits Rule.

cc: Honorable Mark P. Wetjen, Acting Chairman
Honorable Bart Chilton, Commissioner
Honorable Scott D. O'Malia, Commissioner
Mark Fajfar, Assistant General Counsel
Stephen Sherrod, Senior Economist
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ATTACHMENT A

Allegations/Findings of Manipulation in Significant CEA Manipulation Cases for Trading Activity in the Spot Month vs. Non-Spot Month

** Indicates that the case or report is cited by the Commission in the preamble to the Proposed Rule.

Case/Report	*Type of Trader*	*Spot/Non-Spot Month*
In re Abrams, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,479 (July 31, 1995)(Manipulation allegation dismissed)	Speculator	**Spot:** Defendant allegedly manipulated the September 1984 frozen concentrated orange juice contract by acquiring a large long position leading up to the spot month and entering orders above the current market price **during the spot month** in order to liquidate. *Id.* at 43,133-34.
Complaint, ***CFTC v. Amaranth Advisors, LLC***, [2007-2009 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 30,575 (July 25, 2007) STAFF OF PERMANENT SUBCOMM. ON INVESTIGATIONS, COMM. ON HOMELAND SEC. & GOVERNMENTAL AFFAIRS, 110TH CONG., EXCESSIVE SPECULATION IN THE NATURAL GAS MARKET (June 25 & July 9, 2007), *available at* http://www.hsgac.senate.gov//imo/media/doc/REPORTExcessiveSpeculationintheNaturalGasMarket.pdf?attempt=2 (The Commission cites to this report in the Proposed Rule as an example of "how excessive speculation can distort prices of futures contracts that are many months from expiration, with serious consequences for other market participants")**	Speculator	**Spot:** Defendants purchased a large number of natural gas futures contracts before the market close, planning to sell them during the close to attempt to manipulate the settlement price **on the expiration day** of the March and May 2006 contracts. *Id.* at 60,680.
Cargill, Inc. v. Hardin, 452 F.2d 1154 (8th Cir. 1971), *cert. denied*, 406 U.S. 932 (1972)(Manipulation violation)	Hedger	**Spot:** Defendants conducted a squeeze of the May 1963 wheat futures contract **in the spot month** and did not start liquidating their long position until **the last two days of trading** on the contract. *Id.* at 1160, 1162.
In re Cox, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,786 (July 15, 1987)(Manipulation violation dismissed on appeal)	Speculator	**Spot:** Defendants allegedly manipulated the May wheat futures contract on CBOT **during the last day of trading**. *Id.* at 34,059.
Diplacido v. Commodity Futures Trading Comm'n, 364 F. App'x 657 (2d Cir. 2009), *cert. denied*, 559 U.S. 1025 (2010)(Manipulation violation)**	Broker	**Spot:** Defendant **traded on options expiration days** to move the settlement prices for the PV and COB contracts. Corrected Brief of Respondent Commodity Futures Trading Commission, ***DiPlacido* v. *Commodity Futures Trading Comm'n***, No. 08-5559, 2009 WL 7768654, at *7 (June 15, 2009).

Case/Report	***Type of Trader***	***Spot/Non-Spot Month***
General Foods Corp. v. Brannan, 170 F.2d 220 (7th Cir. 1948)(Manipulation allegation dismissed)	Hedger	**<u>Spot:</u>** Defendant allegedly cornered and manipulated cash rye and rye futures in the Chicago market **during the spot month** by taking delivery of large amounts of rye thereby causing an "inflated and manipulated price." *Id.* at 222.
Great W. Food Distribs., Inc. v. Brannan, 201 F.2d 476 (7th Cir. 1953), *cert. denied*, 345 U.S. 997 (1953)(Manipulation violation)	Hedger	**<u>Spot:</u>** Petitioner manipulated **the spot month price** of December 1947 egg futures by purchasing and taking delivery of a large number of cash eggs and egg futures and subsequently offering them for sale at inflated prices. *Id.* at 478.
In re Henner, 30 Agric. Dec. 1151 (U.S.D.A. Sept. 15, 1971)(Manipulation violation)	Broker	**<u>Spot:</u>** Respondent manipulated the November 1968 shell egg futures contract by "simultaneously accept[ing] all of the posted offers" **during the final seconds of the closing period** and making a bid at a price higher than the last trade which was accepted in the minute after the market close. *Id.* at 1152.
In re Hohenberg Bros. Co., [1975-1977 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,271 (Feb. 18, 1977)(Manipulation allegation dismissed)	Hedger	**<u>Spot:</u>** Respondents allegedly artificially depressed "the price of the December 1971 cotton future on and after November 23, 1971 [**the first notice day**]." *Id.* at 21,474.
Complaint, ***In re Hunt***, CFTC Docket No. 85-12 (Feb. 18, 1985) COMMODITY FUTURES TRADING COMM'N, REPORT TO THE CONGRESS IN RESPONSE TO SECTION 21 OF THE COMMODITY EXCHANGE ACT, PART II, A STUDY OF THE SILVER FUTURES MARKETS (May 29, 1981)** H.R. REP. NO. 97-EE (1981) (Testimony of Philip McBride Johnson, Chairman, Commodity Futures Trading Commission)**	Speculator	**<u>Spot:</u>** Defendants took delivery on a large number of silver futures contracts, causing the price of silver to artificially rise and thereby **manipulating spot month prices**. *See, e.g.*, *id.* at ¶¶ 27-29, 51, 60, 74.
Ind. Farm Bureau Coop. Ass'n, [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,796 (Dec. 17, 1982)(Manipulation allegation dismissed)	Hedger	**<u>Spot:</u>** The complaint alleged that Respondents manipulated the July 1973 corn contract through a squeeze **on the last day of trading**. *Id.* at 27,280.
In re Sumitomo Corp., [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,327 (May 11, 1998)(Settlement)	Hedger	**<u>Spot:</u>** Defendants acquired the vast majority of copper stocks over several months in order to artificially inflate prices and benefit from those prices **when liquidating its futures position**; "cash copper prices increased sharply as did the backwardation of cash to three-month forward prices." *Id.* at 46,498.
Volkart Bros., Inc. v. Freeman, 311 F.2d 52 (5th Cir. 1962)(Manipulation allegation dismissed)	Speculator	**<u>Spot:</u>** Defendants allegedly manipulated the price of October 1957 cotton futures **on the last day of trading** by establishing "abnormal or artificially high price[s]." *Id.* at 57.