2001 Pennsylvania Avenue NW
Suite 600 | Washington, DC 20006
T 202 466 5460
F 202 296 3184

May 14, 2020

Via Electronic Submission and Email

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

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

Dear Mr. Kirkpatrick:

The Futures Industry Association ("**FIA**")[1] appreciates the opportunity to comment on and support the U.S. Commodity Futures Trading Commission's ("**Commission**" or "**CFTC**") proposed rulemaking entitled "Position Limits for Derivatives" (the "**Proposed Rule**").[2] The Proposed Rule reflects careful consideration by the Commission and Staff of prior industry comments and is a substantial improvement over prior proposals.[3] It sets spot month limits on core referenced futures contracts based upon updated measures of deliverable supply, is better aligned with current commercial hedging practices, is less burdensome on market participants and will improve market efficiency. For these and the other reasons explained below, FIA is pleased to support the substance of the Proposed Rule. FIA commits to work constructively with the Commission and Staff to help the Commission finalize the Proposed Rule during calendar year 2020.

In reviewing and analyzing the Proposed Rule, FIA and its members focused primarily on what they will need to do to comply with the proposed limits and to qualify for enumerated and non-enumerated hedge exemptions. As a result of our review, FIA makes a number of technical recommendations and suggestions below to help Staff clarify ambiguities in rule text, make the Proposed Rule more commercially practical, and promote a smooth implementation process. FIA also offers comments that it believes will enhance the liquidity and price discovery function

---

[1] The Futures Industry Association is the leading global trade organization for the futures, options and centrally cleared derivatives markets, with offices in Brussels, London, Singapore and Washington, D.C. FIA's membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from more than 48 countries, as well as technology vendors, lawyers and other professionals serving the industry. FIA's mission is to support open, transparent and competitive markets; protect and enhance the integrity of the financial system; and promote high standards of professional conduct. As the principal members of derivatives clearinghouses worldwide, FIA's clearing firm members play a critical role in the reduction of systemic risk in global financial markets.

[2] 85 Fed. Reg. 11596 (Feb. 27, 2020).

[3] 81 Fed. Reg. 96704 (Dec. 30, 2016).

of referenced contracts subject to federal limits. The fact, number and length of FIA's comments and recommendations should not be read to detract from our strong support of the Proposed Rule. On the contrary, we believe that our comments will help the Staff and the Commission promptly finalize a position limits rule that achieves the Commission's regulatory objectives and, at the same time, provides market participants with greater regulatory certainty about how to comply with the final rule.

I. Summary of FIA's Comments

For the convenience of the Commission and Staff, FIA summarizes its comments below.

A. FIA Supports Most Provisions of the Proposed Rule

FIA is pleased to support the majority of the Proposed Rule. In particular, FIA supports:

- The use of updated deliverable supply estimates to set spot month limits.
- The proposal to increase limit levels for legacy agricultural core referenced futures contracts.
- The decision not to impose position limits outside of the spot month for the energy, metals, and certain agricultural core referenced contracts (and related referenced contracts).
- The exclusion of location basis contracts, swap guarantees, and trade options from speculative position limits.
- The exclusion of pre-existing positions from the new proposed limits with the clarifications requested below.
- The definition of referenced contract with the amendments recommended below.
- The definition of economically equivalent swap.
- The expanded list of enumerated *bona fide* hedge transactions with the additions requested below.
- The overall allocation of responsibilities between the Commission and the exchanges.
- The delegation to exchanges of the authority to grant non-enumerated hedge exemptions subject to the proposed Commission review periods.
- The grandfathering of existing *bona fide* hedging positions from federal limits.

- The elimination of the 5-day rule that would have restricted enumerated *bona fide* hedge transactions during the shorter of the last five days of trading or the spot period.

- The adoption of the pass-through swap provision with the modifications recommended below.

- The elimination of position limit reporting forms.

- The determination that the Commission must find that position limits are necessary before it is authorized to establish federal position limits.

- Providing the exchanges with the discretion to set accountability levels for contracts that are not subject to federal limits.

- The exclusion of swaps from exchange-set position limits.

- The proposal to set the date for compliance with a final position limits rule at 365 days following publication of a final rule in the Federal Register.

B. FIA Recommends that the Commission Clarify or Modify the Following Provisions of the Proposed Rule

- The Commission should provide market participants with greater clarity about the referenced contracts subject to federal position limits by, among other things, incorporating from the preamble more detail about material terms in the definition of economically-equivalent swap.

- The Commission should set per designated contract market, rather than aggregated, spot month limits for financially settled referenced contracts.

- The proposed definition of *bona fide* hedging transaction or position should be more flexible.

- The pass-through swap provision should be modified to make it more commercially practical by permitting a dealer or other market participant to demonstrate that it has a reasonable basis to believe that a swap qualifies as a bona fide hedge for its swap counterparty.

- The proposed guidance on the ability of market participants to hedge on a net or gross basis should be streamlined.

- The list of enumerated *bona fide* hedging transactions should be expanded and moved into the rule text.

- The exchanges should be permitted to accept and grant hedge exemptions on a rolling basis in advance of the compliance date of a final rule to facilitate implementation by exchanges and market participants.

- The process for applying to either the Commission or an exchange for a non-enumerated hedge exemption from federal limits should be modified by, among other things, limiting the Commission's 10-day review period only to a participant's initial application and limiting the time in which the Commission must act if it stays an exchange-granted non-enumerated hedge exemption.
- There should be a process for moving commonly used non-enumerated *bona fide* hedge transactions to the list of enumerated *bona fide* hedges.
- The relationship between exemptions granted by different exchanges and between federal and exchange position limits should be clarified.
- The definition of spread transaction and the exemption for spread transactions should be expanded to incorporate commonly used spreads.
- The Commission should retain for itself and the exchanges the flexibility to grant risk management exemptions for contracts that would benefit from more liquidity and enhanced price discovery.
- The Commission should revise its guidance on evasion.
- The definition of "entity" should not refer to the definition of "person" in the CEA.
- Consistent with current exchange limits, the Commission should provide a grace period for market participants to respond to option assignments and changes in delta.
- The Commission should propose cross-border guidance for position limits.
- The Commission should propose amendments to its aggregation rules.

II. FIA's Comments on the Proposed Rule

A. The Commission Should Provide Market Participants with More Clarity About the Scope of the Referenced Contracts Definition

The Commission proposes to define referenced contracts in Rule 150.1 as: (1) a core referenced futures contract; (2) a futures contract, including an option on a futures contract or a spread, that is directly or indirectly linked, including being partially or fully settled on, or priced at a fixed differential to either the price of a core referenced futures contract or the price of the same commodity underlying a core referenced futures contract for delivery at the same location or locations as specified in a core referenced futures contract; and (3) an economically equivalent swap ("**referenced contracts**"). Proposed Rule 150.1 further defines an economically equivalent swap as any swap that has identical material contractual specifications, terms, and conditions to a referenced contract.

FIA generally supports the definition of the referenced contracts that would be subject to the federal position limits under the Proposed Rule. FIA recommends, however, that the Commission provide market participants and the public with more certainty about the scope of the proposed definition of referenced contract.

1. *The Definition of an Economically Equivalent Swap Should Be in the Rule Text*

In order to provide greater clarity about the scope of the proposed definition of referenced contract, FIA recommends that the Commission adopt a more comprehensive definition of "economically equivalent swap." As proposed, the definition of economically equivalent swap requires that the swap share the same "material contractual specifications, terms, and conditions" as a referenced contract. However, the text of Proposed Rule 150.1 does not identify which contractual specifications, terms and conditions are material. Instead, the rule text only identifies the terms that are *not* considered to be material. This means that market participants must parse through the preamble of the Proposed Rule to understand the types of contractual specifications, terms and conditions that are material.

To improve the clarity of the definition of referenced contract, FIA requests that the Commission adopt more comprehensive rule text.[4] In particular, the Commission should move the important discussion in the preamble of material terms, such as the underlying commodity, maturity or termination, and settlement type, into the text of Rule 150.1.[5] More detailed rule text will provide market participants with greater certainty about which swaps are referenced contracts and, therefore, subject to position limits.

2. *The Staff Workbook Should Provide Market Participants with Greater Certainty About the Contracts Subject to Federal Limits*

The current version of the Staff Workbook, which was released to the public in January 2020, provides a non-exhaustive list of futures contracts that Staff believes are referenced contracts subject to federal limits. FIA appreciates Staff's effort to compile this list of referenced contracts for the benefit of market participants. Nevertheless, as FIA has commented in the past, the Workbook should be revised to reduce the uncertainty and burden that market participants will face in trying to identify all contracts that are subject to federal position limits.

FIA recommends that the Staff Workbook include a comprehensive list of futures contracts that fall within the definition of referenced contract and, thus, are subject to federal limits. As proposed, the Staff Workbook only provides regulatory certainty for those futures contracts listed in the Workbook. If a futures contract is not on the list, market participants will need to determine whether a futures contract or option on a futures contract satisfies one of the

---

4 Although the preamble provides helpful information about the Commission's intent in promulgating a rule, the preamble is not itself a rule, and does not appear in widely available resources such as the Code of Federal Regulations.

5 Proposed Rule, 85 Fed. Reg. at 11616.

two directly or indirectly linked requirements. As the Commission is aware, this process is time consuming, involves subjective judgments and likely will result in varying interpretations among market participants about how to characterize the same futures contract. Rather than requiring each market participant to expend significant resources attempting to identify futures contracts subject to federal limits, it would be more efficient if the Staff identified the futures contracts subject to federal limits so market participants can focus their resources on compliance efforts. FIA also notes that the Proposed Rule requires that a DCM notify the Commission if a new contract meets the definition of a referenced contract.[6] These DCM notices will provide the Staff with the information necessary to keep the Staff Workbook up-to-date with a comprehensive list of futures contracts that are referenced contracts.

If the Staff is not prepared at this time to publish a Workbook with all futures contracts subject to federal limits, then at a minimum the Staff Workbook should include a list of the futures contracts that the Staff has considered and determined are *not* referenced contracts.[7] This would help to limit the number of contracts that market participants must analyze as part of their compliance efforts, and would reduce the risk of market participants making inconsistent determinations about those same contracts. In addition, FIA recommends that the Staff Workbook note that to be an "economically equivalent swap," a swap must have identical material contractual specifications, terms, and conditions as a futures contract (or option thereon) identified as a referenced contract in the Staff Workbook. This clarification would provide the public with more information about which swap contracts are subject to federal limits, and would reduce the compliance burden on market participants trying to identify the swaps that are economically equivalent swaps.

3. The Commission Should Work with the Exchanges to Improve the Accuracy of the Staff Workbook

Based upon consultations with CME Group and ICE Futures US, FIA believes that the Staff Workbook excludes futures contracts that fall within the definition of referenced contract. In addition, it includes futures contracts that do not fall within the definition of referenced contract because they are either a locational basis contract or the price is based upon an index published by a price reporting agency that surveys applicable cash market transaction prices. FIA requests that the Commission and Staff continue to work with the exchanges with the goal of issuing a revised and accurate Staff Workbook as soon as possible.

4. The Rule Explaining How to Calculate Futures-Equivalent Position for Swaps Should Exclude an Option that Is a Swap

The definition of "futures-equivalent" in Proposed Rule 150.1 covers futures-equivalent calculations in three categories: (1) option contracts, including an option on a futures contract or a swap that is an option; (2) futures contracts; and (3) swaps. Because the definition of swap in

---

6 *See* Proposed Rule 40.1(j)(1)(vii).

7 The Workbook also should note that any contract not included in a list of non-referenced contracts is not, by implication, necessarily a referenced contract.

Section 1a(47)(A) of the Commodity Exchange Act (CEA) includes an option, FIA recommends that the futures equivalent calculation in subpart (3) only apply to a swap that is not an option. This modification would clarify that the futures equivalent calculation for options that are referenced contracts be made pursuant to subpart (1).

5. The Rule Should Explain How to Calculate a Futures-Equivalent Position for Spreads

As proposed, the definition of a referenced contract would include a spread contract that is not a locational basis contract. For example, a futures contract that settles based upon the difference in price between heating oil and WTI falls within the definition of referenced contract.[8] Although the Staff Workbook includes examples of spread contracts subject to federal limits, the Proposed Rule does not provide guidance regarding how to convert spread positions into futures-equivalent positions. Therefore, FIA recommends that the Commission work with the exchanges to ensure a consistent approach to calculating futures-equivalent positions for purposes of federal and exchange position limits.

B. The Commission Should Set Higher Spot Month Limits for Cash-Settled Contracts

Under the Proposed Rule, the Commission proposes a federal spot month limit for cash-settled referenced contracts set at the same level as the limit applicable to physical delivery referenced contracts. The lone exception is the proposed higher limit for cash-settled natural gas referenced contracts provided that a participant does not hold a position in the natural gas physical delivery core referenced futures contract during the spot month (referred to as the "conditional limit"). The Commission should modify the Proposed Rule to set higher spot month limits for all cash-settled referenced contracts than for physical delivery referenced contracts. Furthermore, the Commission should not impose any conditions on the ability of market participants to qualify for higher spot month limits on cash-settled referenced contracts, including natural gas referenced contracts.

Section 4a(a)(3)(B)(ii) directs the Commission to set limits as appropriate "to deter and prevent market manipulation, squeezes and corners." The Commission acknowledged in the preamble to the Proposed Rule that "corners and squeezes cannot be effected using cash-settled contracts."[9] Cash-settled referenced contracts, irrespective of commodity type, are not subject to corners and squeezes. Accordingly, the Commission should exercise its discretion to set higher spot month limits for all cash-settled referenced contracts. Higher spot month limits for cash settled referenced contracts will, among other things, "ensure market liquidity for *bona fide* hedgers."

In addition, the Commission should set per designated contract market, rather than aggregated, spot month limits for financially settled referenced contracts. Aggregated spot

---

[8] *See e.g.*, Heating Oil Crack - Heating Oil 1st Line vs WTI 1st Line Future (ICE product specifications available here https://www.theice.com/products/6753302).

[9] *See* Proposed Rule, 85 Fed. Reg. at 11628.

month limits for financially-settled referenced contracts will reduce innovation and competition between exchanges because any new proposed financially-settled referenced futures contracts will have to share the same liquidity pool with existing financially-settled referenced futures contracts, including economically-equivalent swaps. A straightforward and efficient way to enhance competition, innovation and liquidity for *bona fide* hedgers would be to set per designated contract spot month limits for financially-settled referenced contracts and to set a separate spot month limit for economically-equivalent swaps.

FIA believes that the Commission should not condition eligibility for higher limits on cash-settled contracts on a participant exiting the physical delivery referenced contract during the spot month. The Commission cited "historical[…] concerns about the possibility of traders attempting to manipulate the physically-settled NYMEX NG contract (*i.e*., mark-the-close) in order to benefit from a larger position in the cash-settled [contracts]."[10] Rather than relying on the blunt instrument of a conditional limit, which treats all spot month positions in the physically-settled natural gas futures contract the same way, the Commission should address its concern about potential cross-product manipulation through its broad anti-manipulation authority in response to particular facts and circumstances. At a minimum, the Commission should permit market participants to hold *bona fide* hedging positions in the physically-settled NG futures contract during the spot month and simultaneously rely upon the conditional limit. Absent such an exception, the Proposed Rule effectively would treat *bona fide* hedging positions as excessive speculation.

C. The Commission Should Simplify the Application of Federal Limits to Pre-Enactment, Transition Period, and Pre-Existing Positions

FIA appreciates the Commission's efforts to address the fact that the Proposed Rule would impose for the first time federal position limits on energy, metals and certain agricultural futures contracts and economically equivalent swaps. In particular, FIA supports the adoption of an exemption for pre-existing positions. However, as proposed, there are varying degrees of exemptive relief depending on whether a transaction is a futures contract or swap, when the transaction was executed, and whether the position would be subject to spot or non-spot month limits. The variability of the exemptive relief makes it operationally challenging for participants to rely upon the relief.

FIA recommends that the Commission streamline the pre-existing position exemption to create two categories of pre-existing positions: pre-existing swaps positions and pre-existing futures positions. Pre-existing swaps positions should include swaps executed prior to the effective date of a final position limits rule, and be exempt from all spot month limits and from non-spot month limits for legacy agricultural referenced contracts. Pre-existing futures positions should include futures positions held prior to the effective date of a final position limits rule, and be exempt from non-spot month limits provided that a market participant does not increase its non-spot month position after the effective date of the final position limits rule. For each of these exemptions, the Commission should clarify that a market participant is not *required* to rely

---

[10] *See Id*. at 11640.

upon the exemption so that its pre-existing positions would net against all other referenced contract positions in its portfolio.

D. The Proposed Definition of *Bona Fide* Hedging Transaction or Position Should Be More Flexible

The definition of *bona fide* hedging transaction or position in the Proposed Rule represents a significant improvement over the Commission's prior proposed definitions. The Proposed Rule appropriately recognizes a wider range of commercial hedging practices that should provide market participants with important risk management options and tools. We believe this improvement generally reflects Congress's intent not to unduly burden bona fide hedgers.

There are some aspects of the proposed definition, however, that are narrower than allowed by the CEA and, in FIA's opinion, will have an adverse effect on liquidity and price discovery in some core referenced futures contracts. FIA's recommendations below are designed to better align the proposed definition with the plain language of the CEA, promote efficient price discovery and risk management, and increase liquidity for *bona fide* hedgers, all in the context of the Commission's regulatory objectives.

1. The Definition of Bona Fide Hedging Transaction or Position in the Proposed Rule Should Be Consistent with the Plain Language of the Definition in the CEA

Although CEA section 4a(a)(1) authorizes the Commission to fix limits as necessary on positions in futures and swap contracts, the general definition of a *bona fide* hedging transaction or position in CEA section 4a(c)(2) applies to "contracts of sale for future delivery or options on the contracts or commodities." Subsection (A) of section 4a(c)(2) provides that, to qualify as a *bona fide* hedge, a futures transaction must: (1) represent a substitute for transactions made or to be made or positions taken or to be taken at a later time in a physical marketing channel (the "Temporary Substitute Test"); (2) be economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise (the "Economically Appropriate Test"); and (3) arise from the potential change in value of (a) assets that a person owns, produces, manufactures, processes, or merchandises or anticipates owning, producing, manufacturing, processing, or merchandising; (b) liabilities that a person owes or anticipates incurring; or (c) services that a person provides or purchases, or anticipates providing or purchasing. In addition, subsection (B) of section 4a(c)(2) provides that to qualify as a *bona fide* hedge, a swap position must: (1) be executed opposite a counterparty for which the transaction would qualify as a *bona fide* hedging transaction; and (2) meet the requirements of the general definition applicable to futures contracts.

FIA believes that the proposed definition of *bona fide* hedging transaction or position in the Proposed Rule, while improved, is still too narrow in some respects. In addition, FIA believes that the CEA provides the Commission with more discretion to recognize *bona fide* hedging transactions or positions.

2. *The Temporary Substitute Test in the CEA Does Not Require that a Hedge "Always" Represent a Substitute for Positions Taken or to Be Taken in a Physical Marketing Channel*

The Commission's preliminary interpretation that the Temporary Substitute Test requires that "a *bona fide* hedging position in physical commodities must *always* be in connection with the production, sale, or use of a physical cash-market commodity" is an overly narrow reading of the CEA.[11] The statutory definition does not require that a hedge "always" represent a substitute for positions taken or to be taken in a physical marketing channel. Moreover, nothing in the cited legislative history supports the inclusion of the term "always," which is not in the statutory text. The deletion by Congress of the word "normally" in the statutory definition does not mean that Congress could only have intended that the definition be read as if it had inserted the word "always" in its place.

FIA believes that the Commission should interpret the definition of *bona fide* hedging in light of the broader purposes of the CEA, including the promotion of sound risk management and price discovery. This interpretation is consistent with the statutory definition of *bona fide* hedging position or transaction. Furthermore, for the reasons FIA explains below, the Commission should not foreclose an interpretation of *bona fide* hedging that allows for non-speculative risk management positions that increase market liquidity and enhance price discovery.

3. *The Economically Appropriate Test Permits the Hedging of All Risks Incurred in the Conduct of a Commercial Enterprise*

The Commission's interpretation of the Economically Appropriate Test, which focuses solely on the reduction of price risk, likewise is too narrow and does not follow from the statutory text of the *bona fide* hedging transaction or position definition.[12] CEA section 4a(c)(2)(A)(ii) provides that to qualify as a *bona fide* hedge, a position must be "economically appropriate to the reduction of *risks* in the conduct and management of a commercial enterprise."[13] FIA recommends, therefore, that the Commission delete the price qualifier in paragraph (1)(ii) of the definition.

The statutory definition refers to risks plural, not risk singular. The text of Section 4a(c)(2)(A)(ii) does not indicate any Congressional intent to limit *bona fide* hedging positions solely to positions that hedge against price risk. Market participants should be permitted to hedge any legitimate risk that they incur in the conduct and management of their commercial operations. The Commission should recognize that the statutory definition of a *bona fide* hedging position encompasses the reduction of all risks that affect the value of a cash-market position, including time risk, location risk, quality risk, execution and logistics risk, counterparty

---

[11] Proposed Rule, 85 Fed. Reg. at 11605 (emphasis in the original).

[12] *Id*. at 11606 (The Commission cites its "longstanding practice regarding what types of risk may be offset by *bona fide* hedging positions in excess of federal limits.").

[13] Emphasis added.

credit risk, weather risk, sovereign risk, government policy risk (*e.g.*, an embargo), and any other risks that affect price. These are objective, rather than subjective, risks that commercial enterprises incur on a regular basis in connection with their businesses as producers, processors, merchants handling, and users of commodities that underlie the core referenced futures contracts. For the convenience of Staff and the Commission, FIA has included in Appendix A hereto an example of a non-price risk incurred by commercial market participants that should be treated as a *bona fide* hedging transaction or position.

The Economically Appropriate Test should treat hedges of all risks that affect the value of a commodity as "economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise." At a minimum, market participants should be able to apply for a non-enumerated hedge exemption in order to hedge risks other than price risk. The exchanges and the Commission then would have the opportunity to review and determine whether, under the particular facts and circumstances, the non-enumerated hedge reduces one or more risks that the applicant incurs in the conduct and management of a commercial enterprise.

4. The Commission Should Modify the Pass-Through Swap Provision to Make it More Commercially Practical

FIA supports the proposed inclusion of pass-through swaps and pass-through swap offsets in the definition of *bona fide* hedging transactions or positions. The proposal would treat as a *bona fide* hedge exempt from speculative position limits (a) a pass-through swap between a market participant, typically a swap dealer, and a *bona fide* hedging counterparty, and (b) a pass-through swap offset (a futures or swap position) that the dealer enters to hedge the risk associated with the pass-through swap. The pass-through swap provision will provide market participants with a tool to implement a Congressionally mandated exemption. Nevertheless, FIA believes that the pass-through swap provision in its current form will be difficult to implement in practice. To make the proposed definition more commercially practical, FIA recommends that the Commission provide for greater flexibility in the requirements imposed on market participants seeking to rely on the pass-through swap provision.

a. A Dealer or Other Market Participant Should be Permitted to Demonstrate that it Has a Reasonable Basis to Believe that a Swap Qualifies as a Bona Fide Hedge for its Swap Counterparty

Under the Proposed Rule, a pass-through swap counterparty (a dealer) would be required to demonstrate upon request that the pass-through swap qualifies as a *bona fide* hedging transaction or position for its counterparty. The Commission indicated in the proposal that it expects that *bona fide* hedging counterparties will provide a representation that a swap is a *bona fide* hedge.

There are many circumstances in which obtaining a representation that a swap is a *bona fide* hedge may not be practical or desirable. A representation about whether a swap qualifies as a *bona fide* hedge is beyond the scope of information that parties ordinarily exchange in the course of negotiating and executing a swap. Consequently, some end-users may be unwilling or uninterested in providing such a representation to a swap dealer. Moreover, determining when

and how to obtain a representation (prospectively at onboarding, in a protocol, during communications between business persons, in each confirmation, *etc*.) raises operational issues and risks. Unless an end user only uses swaps to hedge, the end user cannot represent in advance that all of its swaps are *bona fide* hedging transactions. Without a prior representation by the end user at the time of commencing its trading relationship with the dealer, the end user would need to make the representation on a swap-by-swap basis. During times of a fast-moving market, the commercial representative might be hesitant to make the representation without consulting the advice of his or her counsel or compliance professional. If the dealer expects to rely upon the written representation to be included in the confirmation that is issued after execution of the transaction, it is unclear what the consequences would be if the counterparty objects to the confirmation or merely fails to sign it.

Furthermore, hedging is a dynamic process. It will often be the case that a swap initially is a *bona fide* hedging transaction, but when the underlying cash position settles, the end user may elect to retain the position as a speculative position in anticipation of a later cash market transaction. There is no practical way for a dealer to learn after-the-fact if the original purpose of the underlying swap has changed over time or whether its pass-through swap offset still qualifies as a *bona fide* hedging position.

Another practical problem with a bona fide hedging transaction representation is that it may undermine the utility of a common market practice that has served the best interests of counterparties that seek price quotations from dealers. Frequently, when approaching a dealer for quotations before entering into a swap, many counterparties ask the dealer to quote a two-way market, without indicating whether they are interested in the offer side or bid side of the intended transaction. The counterparty may be requesting a two-way quote because it perceives that by obtaining both the bid and offer, it will have more transparency as to the current market price. Some commercial end-users may seek a two-way quote because they want to prevent the dealer from inferring information about the counterparty's physical positions, commercial operations or hedging strategies. If a dealer finds itself with little or no capacity under a position limit to enter into an offsetting hedge of the intended swap, the dealer may be forced to tell the end user that it is unable to quote a two-way market and can only quote one side at that time. Thus, to the extent that the most likely means of compliance with the pass-through swap proposal would be to require dealers to obtain the end user's representation that it is entering into a bona fide hedging transaction, the proposal would alter a market practice that has worked to the benefit of end users; namely, the quoting of two-way markets. These and the other practical considerations discussed above warrant a more flexible pass-through swap provision.

To address these practical and operational concerns, it should be sufficient for a dealer to demonstrate that it had a reasonable basis to believe, based upon the facts and circumstances, that the swap qualifies as a *bona fide* hedging transaction for its counterparty at the time of the initial transaction. A reasonable basis could be provided, for example, by a representation from the counterparty, the facts that the person is a commercial end-user and the swap appears to be consistent with hedges entered into by commercial end-users in the same line of business, or other relevant facts and circumstances. Providing market participants with additional flexibility

to demonstrate that they qualify to rely on the pass-through swap provision would make it a much more useful and practical tool to implement the exemption.

b. Cross-Commodity Pass-Through Swap Offsets Should be Permitted as Part of the Pass-Through Swap Provision

FIA recommends that the Commission modify the portion of the definition of *bona fide* hedging transactions or positions that addresses pass-through swap offsets. As proposed, the pass-through swap offset must be "in the same physical commodity as the pass-through swap."[14] This requirement appears to be inconsistent with the example described by the Commission of the use of a pass-through swap offset in the ULSD futures contract to hedge a jet fuel pass-through swap.[15] A pass-through swap offset should qualify as a *bona fide* hedging transaction or position without also having to rely on an enumerated cross-commodity hedge exemption.

To address FIA's recommendation that a market participant be able to form a reasonable basis to believe that a pass-through swap qualifies as a *bona fide* hedge, and to clarify that the pass-through swap provision includes cross-commodity hedges, FIA recommends that the Commission modify paragraph (2)(i)(B) as follows:

> The pass-through swap offset is a futures, option on a futures, or swap position entered into by the pass-through swap counterparty ~~in the same physical commodity as the pass-through swap, and which~~ that reduces the pass-through swap counterparty's ~~price~~ risks attendant to that pass-through swap; and provided that the pass-through swap counterparty is able to demonstrate upon request that it had a reasonable basis to believe that the pass-through swap qualifies as a *bona fide* hedging transaction or position pursuant to paragraph (1) of this definition.

5. The Commission Should Streamline its Guidance on the Ability of Market Participants to Hedge on a Net or Gross Basis

In connection with the Proposed Rule, the Commission has issued proposed guidance on hedging exposure on a gross or net basis.[16] The guidance reflects the Commission's preliminary view that there are many different ways in which commercial enterprises are structured and engage in hedging transactions, "including the use of multi-line business strategies in certain industries that would be subject to federal limits for the first time."[17]

FIA supports the Commission's determination to provide market participants with the flexibility to decide whether to hedge on a gross or net basis. FIA believes that market participants should be able to view risk on a business line, regional, legal entity, or aggregated

---

[14] *See* Proposed, 85 Fed. Reg. at 150.1 (definition of *Bona fide* hedging transaction, paragraph (2)(i)(B)).

[15] *Id*. at 11609 n.90.

[16] *See* paragraph (a) of Appendix B to Part 150, 85 Fed. Reg. at 11727.

[17] *Id*. at 11613.

group level, depending upon the unique circumstances of their business. When gross hedging reduces risk, the hedging activity satisfies the statutory standard in CEA Section 4a(c)(2) that the hedging position be "economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise."

The Commission proposes to recognize gross hedging as *bona fide* as long as: "(1) the manner in which the person measures risk is consistent over time and follows a person's regular, historical practice (meaning the person is not switching between net hedging and gross hedging on a selective basis simply to justify an increase in the size of his/her derivatives positions); (2) the person is not measuring risk on a gross basis to evade [position] the limits . . . or . . . the aggregation rules . . . (3) the person is able to demonstrate (1) and (2) to the Commission and/or an exchange upon request; and (4) an exchange that recognizes a particular gross hedging position as a *bona fide* hedge . . . documents the justifications for doing so and maintains records of such justifications. . . ."[18]

a. An Exchange Should not be Required to Document its Justification to Allow Gross Hedging

FIA recommends that the Commission remove the condition that requires an exchange to document its justification for allowing gross hedging. The condition could be read to suggest that gross hedging is a suspect activity, when in fact it is widely used by large diversified enterprises engaged in U.S. commerce as part of prudent risk management. As long as a person complies with conditions (1) through (3), the exchanges and the Commission will have a sufficient basis to conclude that hedging on a gross basis is appropriate. Condition (4), the documentation and recordkeeping requirement, imposes an unnecessary burden directly on exchanges and indirectly on market participants. The focus of a *bona fide* hedge exemption application should be on whether the hedging transactions or positions reduce risk. To the extent that gross hedging reduces risk for a market participant, a factor that will be part of the determination of an exchange-granted hedge exemption, there is no need for exchanges to document and maintain records of their justification to allow a market participant to hedge on a gross basis because it should already be apparent based upon the information submitted by the applicant.

b. The Commission Should Remove from the Preamble its Recommendation that Participants Develop Policies and Procedures Setting Out When Gross or Net Basis is Appropriate

In the preamble to the Proposed Rule the Commission states that "[t]o prevent 'cherry-picking' when determining whether to gross or net hedge certain risks, hedging entities should have policies and procedures setting out when gross and net hedging is appropriate."[19] The Commission also suggests that "[c]onsistent usage of appropriate gross and/or net hedging in line

---

[18] *Id.*

[19] Proposed Rule, 85 Fed. Reg. at 11613.

with such policies and procedures can demonstrate compliance with the Commission's regulations."[20] At the same time, the Commission acknowledges that "the analysis of whether hedging on a gross may be utilized *would involve a case-by-case determination* made by the Commission and/or by an exchange using its expertise and knowledge of its participants."[21]

Risk managers, like the Commission and the exchanges, will have to make the same "case-by-case determination" about when hedging on a gross or net basis is appropriate. Because the commercial circumstances in which hedging activity occurs are constantly in flux, risk managers should have the flexibility to reduce risk in the most appropriate manner based upon then current risk management needs, rather than in response to previously drafted policies and procedures. Furthermore, the recommendation to implement specific policies and procedures governing gross and net hedging has the potential to create unnecessary, unintended and burdensome conflicts with other company policies, such as accounting policies, with little or no measurable benefit. For these reasons, FIA requests that the Commission eliminate this recommendation when it issues a final rule.

E. The Commission Should Make Limited Modifications to the List of Enumerated *Bona Fide* Hedging Transactions or Positions

FIA generally supports the Commission's proposed expanded list of enumerated hedging strategies and offers the following targeted comments to further improve the operation of the enumerated bona fide hedging provisions.

1. The List of Enumerated Bona Fide Hedging Transactions Should be in the Rule Text Rather Than in an Appendix

The Commission proposes to expand the existing list of enumerated *bona fide* hedging transactions (with some modifications) by adding a number of transactions that qualify as *bona fide* hedging transactions or positions. The enumerated *bona fide* hedges would be self-effectuating for purposes of federal position limits.[22] Rather than keeping the list in the rule text, as is the case with the existing rule, the Commission proposes to move the expanded list to proposed Appendix A to part 150 of the Commission's regulations.[23]

FIA recommends that the list of enumerated hedges in Appendix A to Part 150 be moved to the text of the rule in the definitions section. The Commission explained that it proposed to place the enumerated hedges in an appendix, rather than in the definition, because each enumerated hedge represents just one way, but not the only way, to satisfy the proposed *bona fide* hedging transaction definition.[24] Although the Commission does not expect that placing the

---

[20] *Id.*

[21] *Id.* (emphasis added).

[22] Proposed Rule, 85 Fed. Reg. at 11607.

[23] *Id.*

[24] *Id.*

list in an appendix "would have a substantial impact on market participants who seek clarity regarding *bona fide* hedges," it indicated that it would consider feedback on this point from market participants.[25] FIA's members believe that the rationale for putting the list in an appendix – that other transactions also could satisfy the definition of *bona fide* hedging transaction – would apply equally if the list were included in the text of the regulation. In either case, if a hedging strategy is not covered by an enumerated category, a market participant will have to seek a non-enumerated hedge exemption. Including the list in the regulatory text would provide market participants greater regulatory certainty by making it clear that it could not be amended absent notice and comment rulemaking.

2. *The Commission Should Add to the List of Enumerated Bona Fide Hedge Transactions or Positions*

In addition to supporting the inclusion of existing enumerated *bona fide* hedging transactions on the proposed list, FIA strongly supports the proposed addition of hedges of anticipated mineral royalties, hedges of anticipated services, hedges by agents, offsets of commodity trade options, and hedges of anticipated merchandising. Furthermore, FIA supports the Commission's preliminary determination that examples # 4 (binding, irrevocable bids or offers) and # 5 (timing of hedging physical transactions) from the Working Group of Commercial Energy Firms' BFH Petition potentially fit within the proposed Appendix A paragraph (a)(11) enumerated hedge of anticipatory merchandising, so long as the transaction complies with each condition of that proposed enumerated hedge. Each of these proposed new enumerated *bona fide* hedging transactions meets the requirements of CEA section 4a(c).

FIA also recommends that the Commission add three types of hedging transactions to the enumerated list of *bona fide* hedging transactions: (1) a hedge designed to reduce the risk of an unpriced, single-sided, purchase or sale; (2) a hedge designed to reduce the risk of an unfixed priced purchase and an expected unfixed price sale; and (3) a hedge that reduces the risk of the storage and subsequent sale of a commodity. For the convenience of Staff and the Commission, FIA has included examples of each of these types of *bona fide* hedging transactions in Appendix B hereto.

3. *The Commission Should Remove the "Not to Exceed in Quantity 12 Months of Current or Anticipated Purchase or Sale Requirements" Restriction for Hedges of Anticipated Merchandizing*

FIA recommends that the Commission remove the proposed requirement that a referenced contract hedging anticipated merchandising not exceed in quantity 12 months of purchase or sale requirements of the commodity that is anticipated to be merchandised. CEA section 4a(c)(2) does not tie the validity of a bona fide hedge to the duration of the commercial requirements being hedged. Market participants often need to hedge anticipated purchase or sale contracts that exceed in quantity the proposed 12-month quantity restriction. For example,

---

[25] *Id*. at 11608.

because of the large capital expenditures required to develop and operate a precious metals mine, a bullion producer will sell forward to a dealer / merchant at a fixed price a quantity of precious metal that exceeds 12 months of the producer's expected production. The dealer then will need to hedge its anticipated future sales of that same quantity of bullion. Under these circumstances, the merchant has a reasonable expectation of anticipated sales of precious metal beyond a 12-month quantity and should have the flexibility to hedge its exposure on those anticipated sales.

F. FIA Supports the Proposal to Allow Market Participants to Apply to Either the Commission or an Exchange for a Non-Enumerated Hedge Exemption from Federal Position Limits

FIA supports the Commission's determination to allow market participants to apply either to the Commission or an exchange to treat a non-enumerated hedging transaction or position as a *bona fide* hedge. The Commission's delegation of authority to the exchanges to grant non-enumerated hedge exemptions is an integral component of the Proposed Rule that enables the Commission to leverage the expertise of the exchanges, and provide an efficient mechanism for market participants to obtain *bona fide* hedge exemptions. Furthermore, FIA supports the proposed 10-day review process for the Commission to review an exchange grant of a non-enumerated hedge exemption, and for the Commission to either stay, reject, or deem the exchange-granted exemption effective. This proposed process affords the Commission meaningful review of exchange-granted non-enumerated hedge exemptions, and also provides market participants with the necessary certainty at the end of the review process that the hedging transaction or position qualifies as a *bona fide* hedge.

FIA recommends that the Commission clarify the following aspects of the process for an exchange-granted non-enumerated hedge exemption.

1. The Commission's 10-Day Review Period Should Only Apply to a Market Participant's Initial Application

The rule text should clarify that the Commission's 10-day review period applies only when a market participant first applies for a non-enumerated hedge exemption. If the Commission deems the non-enumerated hedge exemption granted after the 10-day review period, a market participant should be able to treat the hedge as a *bona fide* hedge provided that it re-applies to the exchange for an exemption on an annual basis. FIA believes that the Commission intended that its 10-day review period would apply to the initial application, but would not apply to each annual re-application to the exchange because any other process would provide market participants with little certainty as to the status of their non-enumerated hedge exemptions. Accordingly, FIA recommends that the Commission clarify in the rule text that the 10-day review period applies only to an initial application.

2. *If the Commission Stays an Exchange-Granted Non-Enumerated Hedge Exemption, It Should Be Required to Act Within a Defined Time Period*

Under the Proposed Rule, if an exchange grants a non-enumerated hedge exemption and the Commission votes to stay its review of the exchange's action, there is no limit on the time within which the Commission must vote on the exemption. FIA understands that, in certain circumstances, the Commission may need additional time to review and opine on an exchange-granted non-enumerated hedge exemption. However, to ensure that a market participant's exemption application is addressed within a reasonable period, there should be an outside limit on when the Commission must act. In response to question 43 in the Proposed Rule, FIA recommends that, absent extraordinary circumstances, the Commission should be required to vote on an exchange-granted non-enumerated hedge exemption within 30 days of issuing of a stay.[26]

3. *A Market Participant Should Be able to Apply to an Exchange or the Commission for an Exemption Within Five Business Days of Exceeding a Limit*

As proposed, the Commission and the exchanges may allow a market participant to apply for a *bona fide* hedge exemption within five business days after the person exceeded the applicable limit, provided that the person can demonstrate that the position limit overage was due to sudden or unforeseen increases in its *bona fide* hedging needs.[27] FIA agrees that market participants should have the opportunity to apply for a retroactive *bona fide* hedge exemption, but recommends that they be able to apply for a retroactive exemption within five days of exceeding a limit for any reason. FIA's proposal is consistent with current exchange practice and would enable market participants to avoid position limit violations due to an administrative error when the excess positions otherwise would qualify as *bona fide* hedging positions.[28]

4. *The Commission Should Expressly Permit Market Participants to Apply for an Exemption to an Exchange Before the Compliance Date, and Grandfather Existing Exchange-Granted Exemptions*

To promote an orderly transition to the new position limits regime and assist all parties in meeting the compliance date, the Commission should expressly authorize exchanges to grant non-enumerated hedge exemptions, subject to the Commission's 10-day review period, prior to the compliance date of a final rule. Allowing market participants to apply for an exemption before the compliance date will avoid having a large number of market participants simultaneously submit hundreds of exemption applications immediately before the compliance date – a process that would overwhelm the ability of exchanges to review applications and grant exemptions in a timely manner. The absence of an early application process also would

---

[26] *See* Proposed Rule, 85 Fed. Reg. at 11654.

[27] *See* CFTC Rule 150.5(a)(2)(ii)(A)(2).

[28] *See*, *e.g.*, *CME Market Regulation Advisory Notice RA1907-5*, A:10 (Aug. 2, 2019).

overwhelm the ability of the Commission to review exchange-granted exemptions within the applicable review period.

As another means to avoid having numerous market participants apply to exchanges for exemptions at the same time or in a compressed period, the Commission should work with the exchanges to grandfather existing exchange-granted exemptions. In addition, the Commission should permit market participants to continue filing annual applications with the exchanges based upon their existing annual application schedule.

G. There Should Be a Process for Moving Commonly Used Non-Enumerated *Bona Fide* Hedge Transactions to the List of Enumerated *Bona Fide* Hedges

Because hedging is dynamic and evolving, the static list of enumerated hedging positions should be updated periodically. As noted above, FIA supports the Commission's proposed process for recognizing non-enumerated hedges as *bona fide* hedge transactions. FIA expects that over time the exchanges and the Commission will review and grant applications from similarly situated market participants for substantially similar non-enumerated hedging exemptions. Rather than requiring these applications to continue to proceed through the non-enumerated hedge exemption application process, the Commission's position limits rule should incorporate a mechanism for moving commonly granted non-enumerated hedge exemptions to the list of enumerated *bona fide* hedging transactions or positions. Such a process would save significant resources for the Commission, exchanges, and market participants by eliminating unnecessary non-enumerated hedge exemption applications.

FIA would support, for example, a requirement that an exchange publish an anonymized description of non-enumerated hedging exemptions granted by the exchange. In addition, there should be a regular process for the Staff to provide the Commission with a list of non-enumerated hedging transactions that the Staff recommends be added to the list of enumerated hedging transactions. The Commissioners then could review and, if appropriate, approve the Staff recommendations, subject to notice and comment rulemaking.

H. The Commission Should Clarify the Relationship Between Commission-Granted and Exchange-Granted Hedge Exemptions for Positions Subject to Federal Limits

FIA understands that the Proposed Rule cannot account for every potential scenario that may arise after the Commission implements a final position limits rule. However, FIA has listed below common scenarios that FIA expects the Commission to encounter frequently and, thus, recommends that the Commission address them in a final rule.

1. The Size of the Participant's Hedge Exemption from Federal Limits Should be the Higher of Exchange-Granted Exemptions

One likely and recurring circumstance that the Commission should address is when a market participant applies to more than one exchange for a *bona fide* hedge exemption related to the same underlying exposure, but the sizes of the exchange-granted exemptions are different.

For example, one exchange may grant a hedge exemption that authorizes a participant to exceed a speculative position limit by 2,000 contracts, but another exchange may only grant a hedge exemption of 1,800 contracts. FIA's understanding is that exchange-set position limits apply to the exchange's listed reference contracts, and that any exemption granted by the exchange will be specific to its own listed contracts. Under these circumstances, FIA expects that the market participant would need to comply separately with the applicable limit granted by each exchange. However, for purposes of compliance with the federal limit, the Commission should confirm that a market participant could exceed the speculative position limit up to the higher of the two exchange-granted exemptions. In the case of the example referenced above, the market participant could exceed the federal limit by up to 2,000 contracts.

2. *If a Market Participant Exceeds a Federal Limit, but Not an Exchange Limit, It is Not Required to Apply to an Exchange for an Enumerated Hedge Exemption*

Under the Proposed Rule, the enumerated hedge transactions are "self-effectuating" as a *bona fide* hedge for purposes of federal position limits.[29] The preamble also clarifies that, even though the enumerated *bona fide* hedge transactions are self-effectuating for purposes of federal limits, a market participant would still need to apply to an exchange for an exemption from exchange-set limits. FIA requests that the Commission clarify that if a market participant's aggregated positions exceed a federal limit, but not any individual exchange limit, the market participant would not need to apply to an exchange to recognize an enumerated hedge for purposes of federal limits. For example, a market participant may hold positions that are below the limits set by two exchanges, but when those positions are aggregated across the exchanges, they may exceed the federal limit. Under this scenario, the enumerated hedging transactions would be self-effectuating for purposes of federal limits, and there should be no requirement to apply to either exchange for a hedge exemption.

I. The Commission Should Expand and Clarify the Scope of Spread Exemptions

The Proposed Rule establishes an exemption for a "spread transaction," which is defined in Rule 150.1 as "a calendar spread, inter-commodity spread, quality differential spread, processing spread, product or byproduct differential spread, or futures-option spread." Because the proposed list of spread exemptions is exhaustive, if a spread transaction is not on the list, it is not eligible for the spread exemption.

FIA supports the requests of CME Group and ICE Futures US that the Commission expand the list of spread transactions eligible for the spread transaction exemption. In particular, the Commission should define a spread transaction expressly to include an intra-commodity spread, which would provide market participants with an exemption for spreads involving the same commodity, such as a spread between two cash-settled contracts (*e.g.*, a swap and the LD1

[29] Proposed Rule, 85 Fed. Reg. at 11611.

cash-settled futures contract) or a spread between a cash-settled and physical delivery contract (*e.g.*, the LD1 cash-settled futures contract and the NYMEX NG henry hub physical delivery futures contract). An intra-commodity spread exemption would acknowledge the link between the prices of cash-settled contracts and physical delivery futures contracts involving the same commodity.[30] As CME Group and ICE Futures US point out, this type of spread transaction promotes price convergence and provides liquidity in physically-settled futures contracts during the spot period as market participants manage their risks across linked contracts on different exchanges.

FIA also supports ICE Futures US's request that the Commission confirm that exchanges can continue to grant a cash and carry exemption as a spread exemption. ICE Futures US Rule 6.29(e) currently authorizes the exchange to grant a cash and carry exemption in connection with arbitrage, spread and straddle exemptions. The Commission should add this type of spread to the definition of spread transaction.

FIA understands from various examples and comments in the preamble to the Proposed Rule that any "commodity derivative contract," as defined in the Proposed Rule, is eligible to be one leg of a spread transaction that is exempt from federal position limits.[31] Market participants enter into many types of spread transactions to manage price and other related risks. Under the Proposed Rule, one leg of many of these spreads would be a referenced contract and the other leg would not. FIA requests, therefore, that the Commission clarify in the spread transaction definition that a commodity derivative contract may constitute one leg of a spread.

Finally, FIA requests that the Commission adopt a process, similar to the one for non-enumerated *bona fide* hedging transactions, under which market participants can apply to an exchange for a non-enumerated spread exemption. As noted above, the non-enumerated *bona fide* hedging process provides an efficient mechanism for market participants to apply for and receive an exchange-granted exemption subject to Commission review. For the same reasons, the Commission should leverage the expertise of the exchanges and permit them to recognize non-enumerated spread transactions as bona fide hedging transactions, subject to Commission-review.

J. The Commission Should Retain Flexibility to Grant Risk Management Exemptions

In the Proposed Rule, the Commission preliminarily has determined that it no longer can grant risk management exemptions because the Dodd-Frank Act amendments to the CEA removed the word "normally" from the phrase "normally represents a substitute for transactions

---

[30] *See also id.* at 11641 ("In particular, in natural gas, open interest tends to decline in the NYMEX NG contract approaching expiration and tends to increase rapidly in the ICE cash-settled Henry Hub LD1 contract. These dynamics suggest that cash-settled natural gas contracts serve an important function for hedgers and speculators who wish to recreate and/or hedge the physically-settled NYMEX NG contract price without being required to make or take delivery.").

[31] *See*, *e.g.*, Proposed Rule, 85 Fed. Reg. at 11606, 11608, 11638, and 11688 n.617 (discussions of spreads).

made or to be made or positions taken or to be taken at a later time in a physical marketing channel" in CEA section 4a(c)(2). FIA believes that eliminating risk management exemptions is not required by the CEA and may adversely affect market liquidity and the price discovery function of the futures markets. Furthermore, FIA is unaware of any Commission determination that risk management exemptions have had an adverse impact on the derivatives markets.[32] To protect against the adverse effects of eliminating risk management exemptions, FIA recommends that the Commission reconsider its interpretation of the *bona fide* hedging definition or, at a minimum, preserve for itself and the exchanges the ability to grant risk management exemptions in the future for appropriate risk-reducing transactions.

1. Risk Management Positions are not Speculative

Section 4a(a)(1) of the CEA authorizes the Commission to impose limits on speculative positions if it finds that such limits are necessary to prevent excessive speculation from unduly and unnecessarily burdening interstate commerce. Swap dealers and other market participants use futures and swap contracts to manage the price risk associated with financial positions that they enter into to accommodate customer demand. Because these positions reduce, rather than assume, price risk, they are not speculative and, therefore, should not be subject to speculative position limits.[33] Furthermore, the use of futures contracts to hedge against the price risk of financial positions is fully consistent with, not antithetical to, the Dodd-Frank Act's goal of mitigating systemic risk in the derivatives markets.

---

[32] In fact, as discussed in the Proposed Rule, notwithstanding comments that risk management exemptions prevented convergence in the wheat markets, the Commission:

> determined for various reasons that **risk management exemptions did not lead to the lack of convergence** since the Commission understands that many commodity index traders vacate contracts before the spot month and therefore would not influence convergence between the spot and futures price at expiration of the contract. **Further, the risk-management exemptions granted prior to 2008 remain in effect, yet the Commission is unaware of any significant convergence problems relating to commodity index traders at this time. Additionally, there did not appear to be any convergence problems between the period when Commission staff initially granted risk management exemptions and 2007.**
>
> Instead, the Commission believes that the convergence issues that started to occur around 2007 were due to the contract specification underpricing the option to store wheat for the long futures holder making the expiring futures price more valuable than spot wheat.

Proposed Rule, 85 Fed. Reg. at 11676 n.575 (emphasis added).

[33] Section 3(a) of the CEA describes speculative transactions as transactions in which a market participant "assum[es] price risks." The Commission has explained in prior position limits proposals that "speculators would tend to be compensated for assuming the price risk[…]." 81 Fed. Reg. 96704, 96727 (Dec. 30, 2016). The Commission relies upon a similar definition of speculation in other rules. For example, when defining "hedging or mitigating commercial risk" for purposes of CFTC Rule 1.3(kkk), the Commission excluded positions held "for a purpose that is in the nature of speculation, investing, or trading." In the preamble to the further definition of the term Swap Dealer, the Commission explained that "positions executed for the purpose of speculating, investing, or trading are those positions executed primarily to take an outright view on market direction or to obtain an appreciation in value." *See Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant,"* 77 Fed. Reg. 30596, 30676 (May 23, 2012).

2. *Eliminating Risk Management Exemptions Is Likely to Adversely Affect Market Liquidity and Price Discovery*

In determining at what level to impose speculative position limits, Congress directed the Commission to ensure sufficient market liquidity for *bona fide* hedgers and to avoid disruption of the price discovery function of the futures markets.[34] As FIA explains below, eliminating risk management positions is inconsistent with this directive. In fact, eliminating risk management exemptions will reduce rather than promote sufficient market liquidity for *bona fide* hedgers. Indeed, the Commission acknowledges in the preamble to the Proposed Rule that "by excluding risk management positions from the *bona fide* hedge definition (other than those positions that would meet the pass-through/swap offset requirement in the proposed *bona fide* hedge definition, discussed further below), the proposed definition may affect the overall level of liquidity in the market since dealers who approach or exceed the federal position limit may decide to pull back on providing liquidity, including to *bona fide* hedgers."[35] This anticipated loss of liquidity may widen bid-ask spreads, make it less efficient for end-users to hedge and, thus, make it more expensive for end-users to run their businesses. Avoiding increased costs is especially important for end-users given the current liquidity challenges in several key energy derivatives markets.

Because market participants will be precluded under the Proposed Rule from netting exposure across futures contracts and most swaps, the lack of a risk management exemption will limit the ability of liquidity providers, such as swap dealers, to hedge the price exposure they incur in financial positions with commercial end-users and other market participants. This limitation will be particularly acute in the energy futures markets where price convergence between referenced contracts, and between physically-settled futures contracts and the cash market, occurs as the futures contract is expiring.[36]

To foster convergence between the prices of financially-settled and physically-settled energy futures contracts, the exchanges have designed the expiration of financially-settled energy futures contracts to correlate to the last or penultimate trading day of physically-settled energy futures contracts. Swap dealers, as liquidity providers, move their hedges, including risk management positions, between financially- and physically-settled futures contracts to manage their pooled price exposure on a portfolio basis, which decreases the price slippage risk they would incur if they hedged contracts on a one-to-one basis. The hedging activity of liquidity providers increases the futures contract liquidity available to meet the hedging needs of a broader range of market participants, including commercial end-users.

Because of the absence of a risk management exemption and the inability to net physically-settled versus financially-settled contracts, dealers may need to move their hedges

---

[34] CEA section 4a(a)(3)(B).

[35] Proposed Rule, 85 Fed. Reg. at 11683.

[36] In contrast, agricultural and metals futures contracts trade up to and through the delivery month, which provides time between first notice day and last notice day for cash market prices to converge with futures prices while the futures contract is still trading.

from physically-settled futures contracts to financially-settled futures contracts earlier than optimal risk management would normally recommend. Such changed trading behavior would bifurcate the currently pooled commodity price risk in financially- and physically-settled futures contracts, which may lead to a lack of convergence between many referenced contracts over time. As a result, commercial end-users seeking to hedge physical commodity price exposure may find reduced liquidity in the spot month of some of the physically-settled futures contracts.

The bifurcation of liquidity pools may also result in a lack of convergence between the prices of cash-settled and physically-settled futures contracts, and between the prices of physically-settled futures contracts and the underlying cash market. This, in turn, would adversely affect the price discovery function of the futures markets. Because it is difficult to predict which futures contracts may suffer this impairment of liquidity and price discovery, the Commission should adopt FIA's recommendation to preserve flexibility for itself and exchanges to grant risk management exemptions in appropriate circumstances.

Eliminating risk management exemptions may have additional unintended adverse consequences for key users of derivatives. For example, pension plans may execute commodity index swaps that reference several physical commodity futures contracts in order to hedge against the risk of inflation. If the position limits rule impedes the dealer's ability to hedge its commodity index exposure, then the proposed rule will have the unintended consequence of making it less efficient and potentially more expensive for retirement plans to hedge against inflation. This is yet another example of how eliminating risk management exemptions will reduce rather than promote sufficient market liquidity for *bona fide* hedgers.

3. The Commission has the Authority to Exempt Risk Management Positions

Regardless of how the Commission interprets the statutory definition of *bona fide* hedging transactions or positions, it has broad authority under CEA section 4a(a)(7) to exempt "any transaction or class of transactions from any requirement it may establish under this section with respect to position limits." It would be appropriate for the Commission to use this authority to preserve for itself and the exchanges the ability to exempt risk-reducing, non-speculative, risk management positions from federal position limits, especially in cases in which a particular reference contract is in need of greater liquidity and more efficient price discovery.

K. The Commission Should Revise its Guidance on Evasion

The Commission has proposed an anti-evasion provision that would apply to certain transactions if they are used willfully to circumvent or evade position limits.[37] As described by

---

[37] Proposed § 150.2(i) provides that "if used to willfully circumvent or evade speculative position limits:
(1) A commodity index contract and/ or a location basis contract shall be considered to be a referenced contract;
(2) A *bona fide* hedging transaction or position recognition or spread exemption shall no longer apply; and
(3) A swap shall be considered to be an economically equivalent swap."

the Commission, "[t]he proposed anti-evasion provision is not intended to capture a trading strategy merely because it may result in smaller position size for purposes of position limits, but rather is intended to deter and prevent cases of willful evasion of federal position limits, the specifics of which the Commission may be unable to anticipate."[38]

Although FIA supports certain aspects of the proposed guidance, the guidance is overly broad and would be difficult to apply in practice. For example, FIA expects that participants would struggle to distinguish between a strategy that minimizes a position size and a strategy that evades limits. Therefore, FIA recommends that the Commission make the following revisions to its proposed anti-evasion guidance to provide market participants with greater certainty that their trading activity will not be exposed to an after-the-fact challenge as evasive.

The focus of the Commission's anti-evasion analysis should be on the presence of "deceit, deception, or other unlawful or illegitimate activity." Furthermore, this analysis should be based upon the unique facts and circumstances surrounding the trading activity. By shifting the anti-evasion analysis to factors such as deceit or other illegitimate activity, market participants will be better equipped to evaluate the surrounding facts and circumstances to determine whether a transaction structure or trading strategy constitutes evasion.

Consistent with its prior interpretation of other anti-evasion provisions, the Commission should confirm that if a market participant has a legitimate business purpose for a transaction, it is not evasion for the participant to consider "costs or regulatory burdens, including the avoidance thereof."[39] Following this interpretation, if a transaction structure or trading strategy serves a legitimate business purpose, a market participant may appropriately evaluate the most efficient and least burdensome manner to structure the transaction or implement the strategy, including minimizing positions subject to a limit. There is no compelling public policy reason why a market participant should be precluded from changing the structure of a swap when it risks "exceeding a speculative position limit as a result of its swap position, such as by modifying the delivery date or other material terms and conditions such that the swap no longer meets the definition of an 'economically equivalent swap.'"[40] The relevant question is whether the restructured swap still serves the market participant's commercial needs or objectives.

Because swaps previously have not been subject to position limits, all forms of swaps entered into prior to the compliance date should be recognized as not having been structured to avoid position limits. They should be eligible for an automatic safe harbor from a retroactive evasion determination.

Businesses and their risk management needs change over time. Markets and transaction structures evolve and innovate to meet this ever-changing demand. Accordingly, FIA believes that it is not advisable to consider "the historical practices behind the market participant and transaction in question" when attempting to determine whether a transaction has been structured

---

[38] Proposed Rule, 85 Fed. Reg. at 11637.

[39] *Cf. Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping*, 77 Fed. Reg. 48202, 48301 (Aug. 13, 2012).

[40] Proposed Rule, 85 Fed. Reg. at 11635.

to evade position limits. Trying to apply historic practices in a new and different context will increase the risk of reaching the wrong conclusion when evaluating a market participant's intent and conduct.

L. The Definition of "Entity" Should Not Refer to the Definition of "Person" in the Commodity Exchange Act

The Commission proposes to define the term "entity" by cross-referencing the term "person" as defined in Section 1a(38) of the Commodity Exchange Act. This cross-reference creates confusion because the definition of "person" under CEA Section 1a(38) refers to natural persons as well as entities such as associations, partnerships, corporations, and trusts. It is unclear whether, for purposes of the Proposed Rule, the cross-reference to the definition of "person" in the CEA is meant to be limited to non-natural persons. If so, FIA recommends that the Commission amend the definition of "entity" to refer only to the non-natural persons listed in the definition of "person" under the CEA. Furthermore, if a provision in Part 150 applies to both natural and non-natural persons, the rule should refer to "persons." If the rule applies to only non-natural persons, then the rule should refer to "entity."

M. Consistent with Current Exchange Limits, the Commission Should Provide a Grace Period for Market Participants to Respond to Option Assignments and Changes in Delta

Under current exchange limits, the futures-equivalent position of an option on a futures contract is calculated on a delta adjusted basis. The exchanges provide a grace period to address circumstances when a person's futures-equivalent position exceeds an applicable limit due to an option assignment or a change in the delta used to calculate futures-equivalent positions. For example, the answer to question 6 in the CME Group position limits advisory notice explains that:

> Option positions are aggregated into the underlining futures contracts in accordance with the Table on a delta equivalent value.
>
> If a position exceeds position limits as a result of an option assignment, the person who owns or controls such position shall be allowed one business day to liquidate the excess position without being considered in violation of the limits. Additionally, 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.[41]

[41] *See* CME Group Market Regulation Advisory Notice RA1907-5 (Aug. 2, 2019). ICE Futures US Rule 6.13(a) is similar to the CME Group advisory.

FIA recommends that the Commission adopt a similar practice, and incorporate a grace period to address option assignments and changes to delta. The grace period should be set forth in the list of exemptions in Rule 150.3.

N. FIA Agrees with the Commission's Proposed Interpretation that, Before Imposing Position Limits, It Must Find that They Are Necessary

FIA supports the Commission's preliminary determination that it should only establish position limits "as the Commission finds are necessary."[42] Consistent with its prior comments, FIA agrees with the Commission's conclusion that "[CEA section] 4a(a)(2) should be interpreted as incorporating the requirement of [section] 4a(a)(1) that position limits be established only 'as the Commission finds are necessary.'"[43] In the Proposed Rule, the Commission preliminarily finds that federal speculative position limits are "necessary for the 25 core referenced futures contracts, and any associated referenced contracts" based upon a number of factors, including the importance of the contracts to the price discovery process, "the fact that they require physical delivery of the underlying commodities" and, in some cases, the burdens that would be caused by excessive speculation on the prices of these commodities.[44] The Commission's analysis appears to be consistent with the requirements of CEA section 4a(a) when read as a whole and should be applied in promulgating the final rule.

O. The Commission Should Propose Cross-Border Guidance for Position Limits

FIA is concerned that the Proposed Rule does not address the cross-border application of federal position limits other than to identify certain futures contracts traded on a foreign board of trade that would be referenced contracts. For example, the Proposed Rule does not address when a swap that is a referenced contract has a sufficient nexus to the United States that it would fall within the jurisdiction of the Commission under Section 2(i) of the CEA. Currently, if a non-U.S. subsidiary of a U.S. parent executes a swap with a non-U.S. person, the swap is not subject to a U.S. position limits regime. Under a final position limits rule, if that same swap is a referenced contract and, absent an exemption, must be aggregated with positions of the U.S. parent, the non-U.S. subsidiary will be at a significant competitive disadvantage when attempting to compete for swaps business in the relevant non-U.S. market. The competitive and other impacts of the extraterritorial application of a final position limits rule also will depend upon the definition of "U.S. person" for purposes of positions limits.

Because prior Commission guidance on the cross-border application of the Commission's swaps regulations does not address the position limits rules, market participants have no guidance to help them determine which non-U.S. economically equivalent swaps are subject to position limits or to design a compliance program for such swaps during the implementation period. Market participants also will need time to develop an internal process to comply with any cross-border framework that the Commission implements. FIA requests that the

---

[42] Proposed Rule, 85 Fed. Reg. at 11659.

[43] *Id.*

[44] *Id.* at 11664.

Commission adopt cross-border guidance for position limits in advance of any position limits compliance date. FIA is willing to work with the Commission to formulate a commercially practical approach to the application of position limits to cross-border transactions and positions.

P. The Commission Should Propose Amendments to Its Aggregation Rules

Although the Proposed Rule did not address the requirements of Rule 150.4, FIA requests that the Commission address its position limits aggregation rules in a separate proposed rulemaking as soon as possible. The rules dictating how market participants must aggregate positions subject to a federal limit are a necessary component of compliance with the Proposed Rule. Indeed, an effective position limits regime hinges on clear and properly calibrated aggregation rules. The Commission Staff issued no-action letter 19-19 (July 31, 2019) that streamlined the conditions that must be satisfied in order to rely upon certain exemptions from the aggregation requirements. FIA recommends that the Commission promptly amend Rule 150.4 to incorporate the no-action relief. As part of that process, FIA requests that the Commission revisit certain aspects of the aggregation rules and disaggregation relief based upon practical issues and challenges that market participants encounter in complying with the rule. In particular, FIA recommends that the Commission reevaluate the threshold ownership percentage that triggers the requirement to aggregate positions in referenced contracts or eligibility to rely upon an exemption from the aggregation requirement.[45] FIA stands ready to help the Commission address the challenges posed for market participants by the current aggregation rules.

---

[45] The Commission's proposed definition of "eligible affiliates" incorporates a majority ownership concept, suggesting that it is appropriate to reevaluate use of the 10% threshold as a proxy for control.

III. Conclusion

FIA appreciates the opportunity to comment on the Position Limits Rule. Please contact Allison Lurton, General Counsel and Chief Legal Officer of FIA, at 202-466-5460, if you have any questions about FIA's comments or recommendations.

Respectfully submitted,

Walt L. Lukken
President and CEO

cc: Honorable Chairman Heath P. Tarbert
Honorable Commissioner Brian D. Quintenz
Honorable Commissioner Rostin Behnam
Honorable Commissioner Dan M. Berkovitz
Aaron Brodsky, Special Counsel
Steven Benton, Industry Economist
Jeanette Curtis, Special Counsel
Steven Haider, Special Counsel
Harold Hild, Policy Advisor
Lillian Cardona, Special Counsel

APPENDIX A

Example of Non-Price Risk Incurred in the Conduct and Management of a Commercial Enterprise

The value of coffee, like other agricultural and exempt commodities, is sensitive to political, weather, transportation, currency, quality and other risks that directly or indirectly affect the operations of commercial market participants. Coffee producers, merchants and roasting companies take all of these risks into account in determining the size of their hedge positions.[1] To illustrate, a coffee merchant incurs non-price risk when it purchases coffee in one currency and sells it in a different currency. It may be long the local currency at the start of the marketing season in the producing country. As a result, it is exposed to currency risk between the time when it acquires the local currency and when it purchases the coffee beans. The Coffee C futures contract provides an economically appropriate hedge for the coffee merchant's currency risk during these two time periods.

---

[1] The same risks also may incentivize market participant to hedge more than 12 months' quantity of anticipated purchases or sales of coffee.

APPENDIX B

Additional *Bona Fide* Hedging Transactions or Positions that Should Be Added to the List of Enumerated Hedging Transactions or Positions

A hedge designed to reduce the risk of an unpriced, single-sided, purchase or sale. For example, assume that a service station owner ("Owner") requires 25,000 barrels per month of ultra-low-sulfur diesel fuel ("ULSD") to operate its service stations in Connecticut for the next six months (a total of 150,000 barrels). Seeking to protect itself against an increase in the price of ULSD, Owner requests and receives price quotes at the rack from Refiner A in Linden NJ of NYMEX ULSD prompt month plus $0.15 to $0.16, and Refiner B in New Haven, CT of NYMEX ULSD plus $0.17 to plus $0.19. The cost to truck ULSD from the rack in NJ to Owner's service stations in CT averages $0.03 during non-winter months and $0.06 during winter. Factoring in the cost of transportation, Refiner B's offered price is lower. Owner agrees to purchase six months' supply at the rack from Refiner B at NYMEX USLD prompt month plus $0.17. Both Owner and Refiner B still have floating price risk because the price of the cash market transaction is a fixed premium of $0.17 cents to the front month futures contract. Owner hedges its floating price risk by selling six months of NYMEX ULSD futures contracts in a 25 lot strip (25 lots per month over six months). Refiner B also hedges its floating price risk by buying NYMEX ULSD futures contracts. When the futures contract becomes prompt, Owner and Refiner B offset their respective futures positions via an EFP (with delivery of the ULSD at Refiner B's rack in New Haven) and post the EFP price as settlement plus $0.17. The Commission should recognize this type of risk management activity as a *bona fide* hedge because it: (1) is a substitute for a transaction to be made at a later time in a physical marketing channel (*i.e.*, the sale by Refiner B and purchase by Owner of ULSD); (2) is economically appropriate to the reduction of the Owner's and Refiner B's commodity price risk (*i.e.*, the risk that the price of ULSD may rise or fall), and (3) arises from the potential change in value of an asset that Refiner B produces and Owner anticipates owning (*i.e.*, ULSD).

A hedge designed to reduce the risk of an unfixed priced purchase and an expected unfixed price sale. For example, a merchant may agree to buy gasoil for forward delivery at a floating price with the intent to ship the gasoil to New York Harbor and sell it later at a floating price. Prior to executing the sales contract, the merchant could buy gasoil futures and sell ULSD futures in order to lock in the differential in the prices of the current purchase and the anticipated future sale. The Commission should recognize this type of risk management activity as a *bona fide* hedge because it: (1) is a substitute for a transaction to be made in a physical marketing channel (*i.e.*, the sale at New York Harbor); (2) is economically appropriate to the reduction of the marketer's commodity price risk (*i.e.*, the relative value of the sale at New York Harbor), and (3) arises from the potential change in value of an asset that the marketer merchandises (*i.e.*, gasoil).

The Commission also should add to the list of enumerated hedging transactions hedging activity that reduces the risk of the storage and subsequent sale of a commodity. For example, if a merchant leases storage for natural gas, the merchant's hedge of its expected purchase of natural gas to inject into storage followed by its expected sale of natural gas to be withdrawn from storage should qualify as a *bona fide* hedge because it: (1) represents a substitute for a transaction to be made in a physical marketing channel (*i.e.*, the expected purchase and sale of natural gas); (2) is economically appropriate to reduction of the merchant's price risk (*i.e.*, that the merchant will recover the cost of its storage obligation and profit from its business of supplying natural gas); and (3) arises from the potential change in value of an asset that the merchant owns (*i.e.*, storage) and its anticipated owning and/or merchandising (*i.e.*, natural gas).