January 22, 2015

Christopher Kirkpatrick
Secretary
Commodity Futures Trading Commission
1155 21st Street, N.W.
Washington, DC 20581

Re: Notice of Proposed Rulemaking – Position Limits for Derivatives (RIN 3038-AD99)

Ladies and Gentlemen:

The Commodities Working Group ("CWG") of the Global Financial Markets Association[1] welcomes this opportunity to comment on the captioned rule proposal (the "Proposed Rule")[2] published by the Commodity Futures Trading Commission (the "CFTC" or the "Commission") under section 4a of the Commodity Exchange Act (the "CEA" or the "Act"). CWG appreciates the Commission's willingness to reopen the comment period for the Proposed Rule in order to allow interested persons to address the issues identified by the CFTC[3] and discussed at the Commission's Agricultural Advisory Committee meeting on December 9, 2014.

The purpose of this letter is to highlight our concerns with respect to one particular aspect of the Proposed Rule, which we believe is likely to have unintended deleterious consequences for the market for agricultural derivatives and the ability of commercial market participants to obtain

[1] The Global Financial Markets Association (GFMA) brings together three of the world's leading financial trade associations to address the increasingly important global regulatory agenda and to promote coordinated advocacy efforts. The Association for Financial Markets in Europe (AFME) in London and Brussels, the Asia Securities Industry & Financial Markets Association (ASIFMA) in Hong Kong and the Securities Industry and Financial Markets Association (SIFMA) in New York and Washington are, respectively, the European, Asian and North American members of GFMA. For more information, visit www.gfma.org.

[2] 78 Fed. Reg. 75680 (December 12, 2013) (the "Proposed Rule Release").

[3] 79 Fed. Reg. 71973 (December 4, 2014).

liquidity necessary to execute their hedging programs. We offer different alternatives to address this concern.[4]

At the outset, we note that the Proposed Rule is unique among the panoply of rules promulgated based on the amendments made to the CEA by the Dodd Frank Act insofar as it places an outright prohibition on transactions that market participants would otherwise enter into even though those transactions very well may not present risks that the Commission seeks to address through the imposition of position limits. These transactions are often undertaken to manage risks or achieve diversification benefits. Because of the nature of the Proposed Rule and its potential to prohibit appropriate economic activity, we believe that it is particularly important that the Commission take care to draft the final rule in a manner that avoids the possibility of unintended consequences.

A case in point is the subject of this letter – the unintended consequences arising from the treatment of trading related to "commodity index contracts" under the Proposed Rule. In this regard, we draw your attention to the letter submitted by the SIFMA Asset Management Group,[5] which sets out a position with respect to commodity index contracts that we support.[6] We elaborate on our concerns with respect to this issue below.

Commodity Index Contracts and the Proposed Rule

A variety of market participants enter into commodity index contracts to obtain diversification, hedge inflation risk or pursue other investment or risk management strategies. Generally speaking, these market participants enter into commodity index contracts with dealers. The dealers on the other side of these contracts generally hedge the exposures associated with their contractual commitments by purchasing futures contracts on the constituent components of the applicable commodity index. Accordingly, the dealers do not maintain net directional exposure in regard to the components of the commodity index contracts to which they are a party. Rather, they are "short" a commodity index contract, a position that is offset by "long" futures positions. Because of this, the dealers do not maintain speculative positions much less exposures that are susceptible to manipulation or abuse of the type that the Commission states it is seeking to address through the promulgation of the Proposed Rule.[7]

Under the Proposed Rule, position limits apply to "referenced contracts" unless an exemption is available.[8] Single-month and all-months-combined speculative position limits apply to

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[4] The scope of this letter is limited to the topic addressed herein. This letter does not address other aspects of the Proposed Rule or the authority of the Commission to adopt it.

[5] Letter of Timothy W. Cameron and Matthew J. Nevins to Melissa Jurgens, Secretary of the Commodity Futures Trading Commission, dated February 10, 2014 (the "SIFMA AMG Letter").

[6] *Id.* Section 3.5.

[7] The Proposed Rule Release at 75681.

[8] Proposed Rule 150.2.

positions, net long or net short, in referenced contracts without regard to whether the referenced contracts involve physical delivery or cash settlement.[9] The definition of referenced contracts *excludes* commodity index contracts, which in turn are defined as agreements, contracts or transactions that are 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.[10]

As a result of the exclusion of commodity index contracts from the definition of referenced contracts, a market participant of the type described above is not restricted in its ability to enter into commodity index contracts. However, the dealer that provides such contracts is in a different position. The limits under the Proposed Rule apply to a person's net long or short position in "referenced contracts," which include the futures contracts that the dealer acquires as a hedge for its commitments but not the commodity index contracts from which those commitments arise. Thus, the dealer's long futures position is subject to the limits even though the dealer has not taken a speculative position and, therefore, has no net exposure on the commodities that underlie the index contract.

We support the exclusion of commodity index contracts from position limits and agree with the Commission that these contracts do not "involve a separate and distinct exposure to the price of a referenced…contract's commodity price."[11] By the same token, we believe it important to recognize under the Proposed Rule that the dealer in this situation has no speculative position involving directional exposure to the price of any commodity by giving effect to the offset described above. Such recognition will promote liquidity for producers -particularly agricultural producers - that seek to hedge their exposures to commodity prices. This approach will also avoid the inefficiencies and potential disruptions that would result from the anomaly of limiting the recognition of offsets to circumstances other than those that happen to involve contracts linked to the price of more than one core referenced futures contract.

While this letter is not the forum for a detailed economic analysis on the contribution that index swaps make to liquidity for hedging, we do note that producers seeking to hedge their price exposures obtain substantial (if indirect) liquidity from index investors. These investors are particularly well-suited to bear the commodity price risk that producers wish to shed. We also note that the approach of incongruent recognition of offsets reflected in the Proposed Rule would likely splinter the market in a way that could increase volatility and instability.[12] In addition, of particular concern is the fact that the effects of the limited recognition of economic offsets are likely to be most pronounced for agricultural producers since the position limits on agricultural futures contracts

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9 Proposed Rule 150.2(b).

10 Proposed Rule 150.1 "reference contract" definition, paragraph (ii).

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

12 See Testimony of Steven H. Strongin, Managing Director, Goldman, Sachs & Co. to the Permanent Subcommittee on Investigations U.S. Senate, July 21, 2009, available at http://www.hsgac.senate.gov/subcommittees/investigations/hearings/excessive-speculation-in-the-wheat-market.

are likely to be the binding constraint on the capacity of dealers to provide commodity index contracts.

Proposed Solutions

In light of the foregoing, we urge the Commission to address this concern. The first approach would be for the Commission to use its authority under CEA section 4a(a)(7) to recognize the offsetting nature of the dealer's position by exempting the futures contracts that a dealer acquires to hedge its commitments under commodity index contracts as proposed in the SIFMA AMG Letter.[13] If the Commission believes that hedging commodity index exposure is inconsistent with the statutory definition of *bona fide* hedging positions in CEA section 4a(c)(2), we would point out that the Commission's authority broadly to exempt any class of contracts or transactions is independent of the definition of *bona fide* hedging positions. In this regard, the Commission should not view this exemption as expanding the definition of *bona fide* hedging, but rather, exempting contracts or transactions from position limits that are designed to limit speculative activity because they reduce risk and, therefore, are not speculative.[14]

An alternative approach to addressing the concerns outlined herein within the Commission's clear authority and the existing framework of the Proposed Rule would be to modify the definition of "referenced contract" and the definition of "commodity derivative contract" by excluding core referenced futures contracts and related futures contracts, options contracts or swaps that are offset on an economically equivalent basis by the constituent portions of commodity index contracts.[15] In this regard, the Commission has broad authority to define referenced contracts for purposes of the Proposed Rule, as evidenced by the fact that the Commission elected to not subject many futures contracts on commodities to position limits under the Proposed Rule. Furthermore, the Commission has broad authority to prescribe the methodology for exchanges to establish position limits, as evidenced by the varying methodologies set forth in Proposed Rule 150.5.

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[13] CEA section 4a(a)(7) provides: "The Commission, by rule, regulation, or order, may exempt, conditionally or unconditionally, any person or class of persons, any swap or class of swaps, any contract of sale of a commodity for future delivery or class of such contracts, any option or class of options, or any transaction or class of transactions from any requirement it may establish under this section with respect to position limits."

[14] In regard to the Commission's discussion in the Proposed Rule Release, we would note that neither the absence of class limits outside of the spot month nor the availability of offsets for other speculative positions address the specific concerns raised in this letter. The Proposed Rule Release at 75740.

[15] For example, the Commission could exclude from the term commodity index contract in the definition of referenced contract and from the definition of "commodity derivative contract" "any futures contract or swap contract to the extent that such contract offsets the corresponding futures contract component of the commodity index contract of commodity derivative contract." The amount of the permitted excluded offset could be subject to a cap set by the Commission in the case of referenced contracts and OTC swaps, and the exchanges in the case of all other futures contracts.

Conclusion

For the reasons stated above, we urge the Commission to avoid the anomalies and associated impacts to liquidity and the proper functioning of the market that are likely to arise as a result of the Proposed Rule's failure to appropriately address dealers' net risk positions taken to hedge commitments under commodity index contracts.

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We would be pleased to provide further information or assistance at the request of the Commission.

Respectfully Submitted,

David Strongin
Executive Director,
GFMA

cc: Honorable Timothy G. Massad, Chairman
Honorable Mark P. Wetjen, Commissioner
Honorable Sharon Y. Bowen, Commissioner
Honorable J. Christopher Giancarlo, Commissioner
Commodity Futures Trading Commission