MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK

March 30, 2015

Via Electronic Submission: http://comments.cftc.gov

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

Re: RIN 3038-AD99; 3038-AD82; Position Limits for Derivatives and Aggregation of Positions

Dear Mr. Kirkpatrick:

Managed Funds Association ("**MFA**")[1] appreciates the opportunity to provide comments to the U.S. Commodity Futures Trading Commission (the "**Commission**" or "**CFTC**") on its notice of reopening of the comment period relating to the proposed rulemaking to establish speculative position limits for 28 exempt and agricultural commodity futures and options contracts and the physical commodity swaps that are economically equivalent to such contracts.[2] The Commission stated that it intends this comment period to provide commenters with the opportunity to discuss: (1) issues addressed at the Commission's Energy and Environmental Markets Advisory Committee ("**EEMAC**") public meeting held on February 26, 2015 or in the associated materials posted to the Commission's website, as they pertain to energy commodities; and (2) Table 11a, showing counts of the unique persons over certain percentages of the proposed position limit levels based on counts from the period of January 1, 2013, to December 31, 2014 (the "**February 2015 Notice**").[3] MFA has reviewed the February 2015 Notice and carefully considered the topics discussed at the EEMAC meeting and is offering its comments to assist the Commission in its efforts to draft final rules that achieve the Commission's objectives in a way that is consistent with legitimate industry concerns.

---

[1] MFA represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry's contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, the Americas, Australia and many other regions where MFA members are market participants.

[2] Position Limits for Derivatives and Aggregation of Positions, 80 Fed. Reg. 10,022 (Feb. 25, 2015); *see also* Position Limits for Derivatives, 78 Fed. Reg. 75,680 (proposed Dec. 12, 2013).

[3] Position Limits for Derivatives and Aggregation of Positions, 80 Fed. Reg. 10,022.

600 14th Street, NW, Suite 900 | Washington, DC 20005 | 202.730.2600 | Fax 202.730.2601 | www.managedfunds.org

I. BACKGROUND & INTRODUCTION

The Commission has previously published four notices of proposed rulemaking related to the imposition of position limits on physical commodity derivatives. The Commission issued its first such notice in response to energy price volatility and subsequently withdrew the notice.[4] The Commission issued a second notice, and adopted the rules in 2011, but ultimately the United States District Court for the District of Columbia vacated the rules.[5] The Commission issued the third notice, relating to aggregation of positions, and the fourth notice, relating to re-proposed position limits, in 2013.[6] MFA commented on all four proposed rulemakings.[7]

MFA's members are interested in the Commission's new position limits regime because the members rely on fair, competitive, transparent, and liquid markets. MFA members play a vital role in the derivatives industry, including the energy markets, by assuming price risk from commercial participants (hedgers) on the long and short sides of the market, and providing the liquidity that facilitates price discovery and risk transfer for businesses around the world. Any rule proposal that could harm the liquidity or price discovery function of the derivatives markets or that could increase the costs of compliance is of concern to MFA's members.

MFA is concerned that Table 11a shows that the Commission's proposed position limits are too low. We believe the Commission's data and methodology used for setting position limits may be incomplete and/or flawed. As the Commission considers the final position limits rules, we respectfully urge it to examine carefully all relevant data and consider available alternatives in addressing concerns over excessive speculation. The commodity markets

[4] Federal Speculative Position Limits for Referenced Energy Contracts and Associated Regulations, 75 Fed. Reg. 4,144 (proposed Jan. 26, 2010), withdrawn 75 Fed. Reg. 50,950 (Aug. 18, 2010).

[5] Position Limits for Derivatives, 76 Fed. Reg. 4,752 (proposed Jan. 26, 2011); Position Limits for Futures and Swaps, 76 Fed. Reg. 71,626 (adopted Nov. 18, 2011); vacated by *Int'l Swaps and Derivatives Ass'n v. U.S. Commodity Futures Trading Comm'n*, 887 F. Supp. 2d 259 (D.D.C. 2012).

[6] Aggregation of Positions, 78 Fed. Reg. 68,946 (proposed Nov. 15, 2013); Position Limits for Derivatives, 78 Fed. Reg. 75,680 (proposed Dec. 12, 2013).

[7] Letter from Richard H. Baker, President and CEO, Managed Funds Association, to David A. Stawick, Secretary, Commodity Futures Trading Commission (Apr. 26, 2010), *available at* http://www.managedfunds.org/downloads/MFA%20CFTC%20energy%20spec%20limits.4.26.10.pdf ("**MFA 2010 Comment Letter**"); Letter from Richard H. Baker, President and CEO, Managed Funds Association, to David A. Stawick, Secretary, Commodity Futures Trading Commission (Mar. 28, 2011), *available at* http://www.managedfunds.org/wp-content/uploads/2011/06/3.28.11-MFA_Position_Limits_final.3.28.pdf ("**MFA 2011 Comment Letter**"); and Letter from Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, Managed Funds Association, to Melissa D. Jurgens, Secretary, Commodity Futures Trading Commission (Feb. 9, 2014), *available at* https://www.managedfunds.org/wp-content/uploads/2014/02/MFA-Position-Limits-final-2-9-14.pdf ("**MFA 2014 Comment Letter**"). MFA also commented on the Commission's separate rulemaking on aggregation of positions. Letter from Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, Managed Funds Association, to Melissa D. Jurgens, Secretary, Commodity Futures Trading Commission (Feb. 7, 2014), *available at* https://www.managedfunds.org/wp-content/uploads/2014/02/MFA-Aggregation-Limits-final-2-7-14.pdf.

currently function quite well. If anything, certain markets may suffer from insufficient speculation rather than too much speculation.[8]

The final position limits rules should be designed in a way that minimizes their impact on market liquidity and reduces the costs of compliance on industry participants. To achieve these goals, MFA recommends that in setting position limits, the Commission use accurate and complete data and review its methodology to establish position limits. By so doing it will avoid establishing limits that are too low and that are not reflective of actual market dynamics. MFA further recommends that the Commission adopt position limits through a two-phase approach. In the first phase, the Commission should adopt spot-month limits, finalize the definition of *bona fide* hedging, and rely on exchange position accountability levels for non-spot month contracts. In the second phase, the Commission should itself adopt position accountability levels for non-spot month contracts to provide greater flexibility to market participants and regulators and to reduce the costs of compliance with hard position limits in non-spot month contracts. To the extent the Commission determines to impose position limits outside the spot month, it should do so in the second phase of a two-phase approach, after having received the benefit of new data from the first phase.

II. COMMENTS

In developing a position limits regime, the Commission should consider a framework that does not unduly disrupt markets and minimizes unintended consequences. The Commission should strive to strike the appropriate balance among the Commodity Exchange Act's (the "**Act**") statutory considerations when imposing position limits.[9] Speculators, including MFA's members, perform an essential function in the energy markets by transferring risk from commercial participants, providing liquidity to both sides of the market,[10] reducing volatility, and contributing to the price discovery process, which benefits hedgers and all consumers and producers of energy.[11]

[8]Testimony of Erik Haas, Director of Market Regulation, ICE Futures U.S., Before the CFTC's EEMAC Meeting 82 (Feb. 26, 2015) ("**Haas Testimony**") (stating that ICE Futures U.S. often receives complaints that markets are too wide out the curve and that "there is not enough participation"); Testimony of Lael Campbell, Director, Governmental and Regulatory Affairs and Public Policy, Exelon, Before the CFTC's EEMAC Meeting 83 (Feb. 26, 2015) ("**Campbell Testimony**") (stating "it sounds to me like we may have an excessive hedging problem.").

[9]Section 4a(a)(3) of the Act specifies that if the Commission sets federal position limits, it must strive to achieve the following four statutory goals: (i) to diminish, eliminate, or prevent excessive speculation; (ii) to deter and prevent market manipulation, squeezes, and corners; (iii) to ensure sufficient market liquidity for bona fide hedgers; and (iv) to ensure that the price discovery function of the underlying market is not disrupted. 7 U.S.C. § 6a(a)(3).

[10]"The short hedgers and long investors provide liquidity for each other by using futures markets to serve their respective interests in an open, transparent and efficient manner. Liquidity will be essential to make sure each can achieve their objectives at an efficient price. Artificial limits on that liquidity should not be imposed. There are numerous ways to further the objectives of enhanced transparency and reduced systemic risk that do not involve reductions in much needed liquidity." Testimony of Kevin Norrish, Managing Director of Commodities Research, Barclays Capital, Before the CFTC 4 (Mar. 25, 2010).

[11]*See*, *e.g.*, "A Review of Recent Hedge Fund Participation in NYMEX Natural Gas and Crude Oil Futures Markets", New York Mercantile Exchange (Mar. 1, 2005); "Populists versus theorists: Futures markets and the volatility of prices" (Jun. 2006), Explorations in Economic History 44 (2007) 342-362, David S. Jacks, *available*

MFA is concerned, however, that the proposed position limits may constrain effective risk transfer by unduly restricting hedging or limiting the risk-bearing capacity of large speculators, thereby causing reduced liquidity, wider bid-offer spreads and higher transaction costs.[12] Market participants already are moving to over-the-counter transactions where they incur bilateral exposure because futures contracts have become too costly the further out the curve one goes.[13] We are also concerned that the Commission's proposed position limits may actually undermine the Commission's intent to encourage market transparency and reduce systemic risks through centralized clearing.[14] We believe that the proposed limits will cause participants to move their transactions to less-transparent and non-cleared markets due to a lack of liquidity on futures markets. In our letter, we identify some specific concerns with respect to the Commission's proposed position limits and provide recommendations.

A. The Commission's Basis for Position Limits Should Be Based Upon Accurate and Reliable Data

MFA is concerned that the Commission's data – including the new data in Table 11a that provides the number of unique persons over specified percentages (i.e., 60%, 80%, 100%, or 500%) of the 28 proposed position limit levels from January 1, 2013, to December 31, 2014 – appear to demonstrate that the position limits have been set too low. Moreover, the data provided appear insufficient to permit a meaningful analysis of the impact of the proposed position limits regime on market participants. MFA respectfully requests that the Commission reevaluate position limits using additional, reliable, high-quality data relevant to the energy commodity markets, especially for contracts for which the Commission has not made a necessity finding.[15]

1. The Data Demonstrate That the Proposed Position Limits Are Miscalibrated and Have Been Set Too Low

Table 11a identifies the number of unique persons at or above various percentages of the proposed position limit levels. As we describe below, it is difficult to analyze the data in Table 11a because the Commission does not provide sufficiently detailed information to identify whether the unique persons are engaged in hedging or speculative activity. However, without more information from the Commission, we can only assume that a portion of unique persons are speculators. For example, Table 11a identifies 205 unique persons holding cash-settled NYMEX

---

*at*www.sciencedirect.com. We have referenced these studies in previous comment letters. *See* MFA 2010 Comment Letter at 2; MFA 2014 Comment Letter at 13.

[12]During the EEMAC Meeting, Erik Haas explained that hedging further out the curve is "getting more expensive and harder to do" and, in turn, bid-offer spreads are wider. Haas Testimony at 82.

[13]*See, e.g., id.* at 90-91.

[14]*See, e.g.*, Position Limits for Derivatives, 78 Fed. Reg. at 75,737. The Commission describes the goals of position limits as "deterring market manipulation, ensuring the price discovery function of the underlying market is not disrupted, and deterring disruptive trading during the closing period." *Id.*

[15] While MFA's comments in this letter pertain to energy contracts, MFA believes that the Commission should consider the same issues in the context of metals contracts.

Henry Hub contracts in the spot month that represent 80% of the proposed position limit level; 187 unique persons hold positions equivalent to 100% of the proposed position limits; and 46 unique persons hold positions equivalent to 500% of the proposed position limits.[16] Based on these data, it appears that the markets are functioning with a high level of legitimate activity near, at or above the proposed position limit levels. The Commission's intent appears to be to restrict this activity by imposing position limits. The Commission seems to suggest that excessive speculation exists in the markets, but the Commission has not made a finding that there is excessive speculation at the position limit levels it has proposed, where, currently, a great deal of activity occurs.

With no finding that excessive speculation currently exists in the energy contract markets or other markets, and considering the large number of unique persons above 80%, 100% or 500% of the proposed position limit levels in many commodities in Table 11a in both the spot and non-spot months, it appears that the Commission is proposing position limits at levels that are too low. The data in Table 11a appear to indicate that there are a large number of traders who are close to exceeding or exceeding the proposed position limit levels. In the event of a sudden change in market conditions, the proposed position limits would even constrain the abilities of unique persons at the 80% level to manage risk because there would be little flexibility under the proposed position limit levels for market participants to take on more positions. Table 11a leads us to conclude that in setting position limits, the Commission is relying upon incomplete data and/or the methodology for setting spot month and non-spot months are inappropriate.[17]

By contrast, position accountability levels, which have been used successfully by futures exchanges, would provide the necessary flexibility to enable market participants to respond to changes in market conditions without violating hard position limits.[18] Accordingly, MFA requests that the Commission reevaluate the proposed position limits in the context of relevant market data and methodology specific to each commodity and, as further discussed below, establishing position accountability levels in the non-spot months.

2. The Data Are Not Sufficiently Detailed to Effectively Analyze the Proposed Position Limits

The lack of transparency as to the Commission's data and methodology that underlie important portions of the proposed position limits rule makes it difficult, if not impossible, for affected market participants to evaluate and meaningfully comment on significant aspects of the proposal. For example, the data in Table 11a have been compiled over a two-year period; however, the Commission has not identified whether the unique persons at or over the percentages of the proposed position limits would have breached these levels on just one day out

[16]Position Limits for Derivatives and Aggregation of Positions, 80 Fed. Reg. at 10,025.

[17] *See* Position Limits for Derivatives, 78 Fed. Reg. 75,680 (proposed Dec. 12, 2013) (proposing to set spot month limits at 25% of deliverable supply, and single-month and all-months-combined limits at 10% of the first 25,000 contracts and 2.5% of open interest beyond 25,000 contracts).

[18] *See infra* Section C for a discussion on position accountability levels.

of the two-year period or on all of the days of the two-year period. It is unclear whether or how the Commission verified the data in Table 11a, for example, by contacting the unique persons at or over the specified percentages of the proposed position limits to confirm the Commission's calculations.

The data in Table 11a do not distinguish unique persons who are speculators and hedgers at each percentage level. In fact, the Commission does not know "whether a trader's position today is hedge or spec" because the Commission does not gather this level of detailed information in its Commitment of Traders Reports.[19] The identification of hedgers and speculators at or above the specified percentages of the proposed position limits is fundamental to effectively determine the impact of the proposed position limits. Where there is a greater number of speculators at a given percentage level, the proposed position limits will have a more significant impact. Without more information, it is difficult to analyze the impact the proposed position limits would have on the energy markets.[20] Thus, MFA recommends that the Commission obtain and analyze further data before considering implementing position limits.

3. The Commission Should Consider Market-Appropriate Methodology and Data with Respect to Position Limits

If the Commission determines to impose position limits, MFA encourages the Commission to reconsider the methodology and data it has used to establish the proposed position limits for the spot month and outside of the spot month.

The Commission uses the deliverable supply of a commodity to compute spot month limits. However, the Commission should not use a one-size-fits-all method of computation. Deliverable supply should be calculated differently for energy markets than for other commodity classes by considering energy products that are in a different location but can serve demand in certain areas through the transportation of the products. Thus, estimated deliverable supply should be based on pipeline capacity for natural gas and transmission for power as opposed to load or generation at a certain location.[21]

With respect to non-spot month limits, the Commission's data and proposed position limits should take into account the fact that open interest traits varies widely between agricultural

---

[19]Testimony of Stephen Sherrod, Senior Economist, Division of Market Oversight, CFTC, Before the CFTC's EEMAC Meeting 85 (Feb. 26, 2015).

[20]MFA has commented on the reliability of the Commission's data in the past. In the MFA 2014 Comment Letter, we shared our concern about the accuracy of the data used to measure open interest of over-the-counter swaps and noted that the Commission has acknowledged reporting errors. The Commission has stated: "Several reporting entities have submitted data that contained stark errors. For example, certain reporting entities submitted position sizes that the Commission determined to be 1000 times, or even 10,000 times, too large." Position Limits for Derivatives, 78 Fed. Reg. at n.428, 75,734. *See also* Dissenting Statement of Commissioner Scott O'Malia, Position Limits for Derivatives, 78 Fed. Reg. at 75,841 ("It is especially troubling that the large trader data being reported under Part 20 of Commission regulations is still unreliable and unsuitable for setting position limit levels, almost two full years after entities began reporting data, and that we are forced to resort to using data from 2011 and 2012 as a poor and inexact substitute.") (internal citation omitted).

[21]Haas Testimony at 100.

and energy markets. Agricultural markets have relatively few contract months with open interest in the back months because the majority of open interest is front-loaded in the first two or three contract months.[22] In contrast, open interest in ICE's Henry Hub contract exists across 142 different contract months, with only 20% of that open interest in the front three contract months.[23] In fact, to reach the 99% level of open interest in ICE's Henry Hub contract, one must look out 70 months.[24]

Different levels of open interest for agricultural and energy markets establish a meaningful distinction between these markets. The high level of open interest in the back months of the energy markets translates to the need for liquidity in these longer-dated contracts to effectively manage risk out the curve. All-months-combined position limits in energy contracts could severely constrain liquidity in longer-dated contracts, especially if: (1) the limits are set in the same manner as for agricultural contracts; and (2) it is the same entities providing speculative liquidity in the longer-dated contracts as in short-dated contracts. It is not clear that if existing speculators are limited from providing liquidity in longer-dated contracts that new market participants will step in to fill that void given the inherent risks in trading in more illiquid contracts. Thus, MFA recommends that the Commission analyze the different traits and characteristics of markets and use market-appropriate methodology in setting position limits, or considering whether single month and all-months-combined limits are even necessary in some markets.

4. <u>The CFTC Should Reevaluate Position Limits Where It Has Not Made a Necessity Finding</u>

We do not believe that the Commission has demonstrated that position limits are necessary outside of the spot month; and accordingly are not convinced that the proposed limits set forth in Table 11a would not harm market participants or markets. The Commission has not offered empirical support for the propositions that hard position limits are necessary, have reduced undue price volatility in agricultural commodities or will reduce volatility in energy markets.[25] The Commission does not explain why the agricultural model would be correctly applied to energy contracts in view of the different characteristics that distinguish these markets. MFA believes the Commission should make a necessity finding prior to imposing position limits, particularly because the energy markets have unique characteristics that differentiate them from the agricultural markets; but also to ensure that position limits would not harm market participants or markets.

---

[22] *Id.* at 66-67.

[23] *Id.*

[24] *Id.* Only 50% of open interest in ICE's Henry Hub contract is in the first year. *Id.* Eighty-three different contract months exist for power contracts, with 50% of open interest in the first 12 contract months and 99% of open interest 60 months out the curve. *Id.*

[25] "[W]e do not believe a case has been made which demonstrates that prices of commodities, or other financial derivatives, can be effectively controlled through the mandatory operation of regulatory tools such as position limits, whether on exchange or OTC. Analysis of market data where position limits are already in use suggests this has not shown a reduction in volatility or absolute price movements compared to contracts where they are not." Financial Services Authority & HM Treasury, Reforming OTC Derivative Markets, A UK perspective (Dec. 2009), at 34.

The energy markets are more global, energy commodities are more fungible, supplies of energy commodities are much greater and production is subject to less seasonal variation than with agricultural commodities. Macro events affect energy markets' liquidity needs on a larger scale than they affect agricultural markets. For example, in 2011, due to civil unrest in the Middle East (the "Arab Spring"), production of crude oil suddenly declined by 1.5 million barrels per day, while demand for crude oil was increasing from growth in emerging markets.[26] Position limits could harm market participants and markets if they limit the ability of market participants to respond quickly to these types of global events, seasonal trends or other economic forces.

Also, as discussed above, the distribution of open interest in energy markets is significantly different from agricultural markets in that open interest is concentrated less in the first two or three contract months but extends to multiple months beyond the spot month. As such, all-months-combined limits would likely impact energy markets more drastically than agricultural markets. Again, it is not clear to us that single month or all months limits are necessary in the energy markets, or that they would not impose more harm than benefit.

The energy commodity markets are well functioning, as demonstrated by the existence of model convergence and transactions in contracts with wide-ranging maturities in the energy markets.[27] Where there are low levels of liquidity in contracts with further-dated maturities (such as several years from delivery), such low liquidity appears to be caused by "excessive hedging" that could be solved by increasing the number of speculators to increase liquidity in further-dated contracts.[28] MFA is concerned that the Commission has determined to impose position limits even though it has not found that position limits are necessary with respect to energy commodities, and encourages the Commission to conduct further analysis on the necessity of position limits before imposing limits. As discussed below, MFA recommends that the Commission adopt position accountability levels outside of the spot month, or rely on exchange position accountability levels, in order to collect further data to assist in analyzing energy markets, as discussed below.

B. The Commission Should Adopt Position Limits Through A Two-Phase Rulemaking Approach

In light of concerns regarding the sufficiency of the data being used by the Commission, MFA believes that the Commission should adopt position limits through a two-phase rulemaking approach. In the first phase, the Commission should adopt spot-month position limits, finalize the *bona fide* hedging definition, and rely on exchange position accountability levels for non-spot months. During the second phase of rulemaking, the Commission should adopt position accountability levels for non-spot months based upon data gathered during the first phase. The phased-in approach decreases the risk of market disruption by affording the Commission better

[26]U.S. Energy Information Administration, 2011 Brief: Brent Crude Oil Averages Over $100 Per Barrel in 2011, *available at* http://www.eia.gov/todayinenergy/detail.cfm?id=4550.

[27]*Id.*at 69.

[28]Campbell Testimony at 83.

data on which to base non-spot month position accountability levels and by giving market participants adequate time to comply with a comprehensive position limits regime encompassing a large number of contracts.

MFA encourages the Commission to adopt a two-phase approach to position limits to enable the Commission to observe the functionality and impact of the spot-month limits and better understand the impact from the change in definition of *bona fide* hedging on market behavior. The Commission could use this information to measure the impact of spot-month position limits on the markets and to analyze position accountability levels for non-spot months. Recently, the Commission has implemented a phased-in approach for other types of rulemakings to ease the transition for market participants.[29] A phased-in approach should be adopted for the position limits regime to provide market participants with adequate time to adjust their internal operations and risk management systems and compliance programs to the new position limits regime, while decreasing the likelihood of constricting liquidity in any of the 28 exempt and agricultural commodity futures and options contract markets.

After implementing the first phase, the Commission will have the benefit of new data. Thus, even if the Commission determines that position limits are necessary outside of the spot month rather than position accountability levels, it will at least have better data on which to base position limits. MFA respectfully requests the Commission to implement this type of two-phase approach when adopting the final position limits regime.

[29]For example, the Commission addressed similar concerns related to the adverse impact that the adoption of the residual interest requirement under the enhancing customer protection rules would have on the market, if the Commission made the deadline for compliance with that requirement by futures commission merchants' ("FCMs") and their customers' too short. Commission final rule "Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations", 78 Fed. Reg. 68,506 (Nov. 14, 2013), available at: http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/federalregister031715.pdf.. In response to market participants' concerns, in the final rule, the Commission set the initial residual interest deadline as 6:00pm ET on the date of settlement, and provided a five-year phase-in approach during which the deadline for FCMs' compliance would automatically decrease over time. In addition, during the phase-in, the Commissioner required Commission staff to complete and publish for public comment a report addressing the practicability for FCMs and customers of complying with a shorter deadline. *See id*. at 68,550, 68,578.

Using such a phase-in approach allowed the Commission to analyze the market impact of shortening the residual interest deadline and determine that the automatic decreases of the deadline provided in the final rule were inappropriate. As a result, on March 17, 2015, to "provide the Commission with a greater degree of flexibility to assess all relevant data, including the costs and benefits of revising the Residual Interest Deadline", the Commission approved a new final rule that terminated the phase-in compliance period for the residual interest deadline, and made permanent the existing deadline of 6:00pm ET on the date of settlement. Commission final rule "Residual Interest Deadline for Futures Commission Merchants", 80 Fed. Reg. 15,507 (Mar. 24, 2015), available at: http://www.gpo.gov/fdsys/pkg/FR-2015-03-24/pdf/2015-06548.pdf.

C. The Commission Should Impose Position Accountability Levels Rather Than Hard Limits Outside of the Spot Month

MFA recommends that the Commission adopt position accountability levels instead of position limits outside of the spot month to increase the Commission's regulatory flexibility and the flexibility of market participants. The Commission should adopt position accountability levels during the second phase of rulemaking as MFA recommends above. To the extent the Commission determines to impose position limits rather than position accountability levels, it should still do so as part of the second-phase of a two-phase approach. The position accountability regime has been successfully applied by futures exchanges and allows regulators to obtain a deeper insight into market dynamics through dialogue with market participants as they become near or exceed the position accountability threshold.

<u>1. The Commission Should Adopt a More Flexible Approach to Achieve a Better Outcome</u>

Futures exchanges impose position accountability levels because they maintain the market's integrity by providing necessary oversight of any market participant while ensuring sufficient liquidity to allow traders to enter and exit the market without being overly burdensome to traders who, at times, may hold large positions. Position accountability levels are similar to position limits in that a trader who reaches the position accountability level will be exposed to increased exchange scrutiny of the trader's positions. Unlike position limits, position accountability levels do not prohibit a trader from reaching or exceeding the level. Instead, once a trader hits a position accountability level, an exchange may take certain actions, including preventing the trader from increasing the position or requiring the trader to reduce the position.[30] Since at least 1991,[31] the Commission has permitted exchanges to impose position accountability

[30]CME Rule 560 (stating in part: "A person who holds or controls aggregate positions in excess of specified position accountability levels or in excess of position limits pursuant to an approved exemption shall be deemed to have consented, when so ordered by the Market Regulation Department, not to further increase the positions, to comply with any prospective limit which exceeds the size of the position owned or controlled, or to reduce any open position which exceeds position accountability or position limit levels."); ICE Futures U.S. Rule 6.13 (providing the exchange with the authority to "instruct each such Clearing Member to reduce the positions in such accounts twenty-four (24) hours after receipt of the notice, proportionately or otherwise so that the aggregate positions of such accounts at all such Clearing Members does not exceed the position limits and position accountability levels established by this Chapter").

[31]In 1991, the Commission granted CME an exemption from position limits with respect to foreign currency and financial instrument contracts. Speculative Position Limits – Exemptions From Commission Rule 1.61; Chicago Mercantile Exchange Proposed Amendments to Rules 3902.D, 5001.E, 3010.F, 3012.F, 3013.F, 3015.F, 4604, and Deletion of Rules 3902.F, 5001.G, 3010.H, 3012.H, 3013.H, and 30.15.H, 56 Fed. Reg. 51,687, 51,688 (Oct. 15, 1991). The Commission provided that energy contracts would be eligible for exemptive relief because they are characterized by underlying cash markets with liquidity equal to or greater than certain financial futures and options that the Commission had already exempted. *See* Revision of Federal Speculative Position Limits and Associated Rules, 63 Fed. Reg. 38,525, 38,530 (proposed Jul. 17, 1998). Under the proposed position limits rules, the Commission would allow an exchange "to establish position accountability rules as an acceptable alternative to position limits outside of the spot month for physical commodity contracts when a contract has an average month-end open interest of 50,000 contracts and an average daily volume of 5,000 contracts and a liquid cash market." Position Limits for Futures and Swaps, 76 Fed. Reg. at 71,660.

levels on certain contracts.[32]

Exchanges value the flexibility provided by position accountability levels because they can make educated determinations as to whether a trader's positions could become problematic. The further out the curve market participants transact in derivatives, the number of market participants and liquidity both decrease.[33] Those traders who engage in the first trade in a back month will hold all of the open interest in that contract, but this is not necessarily problematic.[34] Rather, it is essential to creating liquidity in these contract months.[35] Moreover, exchanges can continually monitor *concentrations* the further out the curve a trader is transacting.[36] Position accountability levels enable exchanges to monitor different levels of open interest without adversely impacting liquidity, yet provide the exchanges with the authority to intervene when appropriate.

Position accountability levels are intended to be a proactive method of monitoring the markets, and therefore it is appropriate to apply position accountability levels outside of the spot month and analyze concentrations using multiple factors to "cumulatively determine if a position should be continued to be carried."[37] For example, CME considers the following factors to determine the appropriate action to take when a market participant reaches the position accountability level: (1) the absolute size of the position relative to the size of open interest in the relevant contract; (2) the nature of the market participant's business (speculator, traditional hedger, or swap dealer); (3) the size of the position relative to other position holders or comparable entities; (4) the type of the position (outright, intra-commodity spread, inter-commodity spread); (5) the location of the position on the curve (expiration, near expiration or deferred month); (6) market fundamentals (whether there is a congested market, unusual basis or spread relationship); (7) the position relative to the historical position levels for the account in question as well as the account's history of managing its positions; and (8) whether the market participant exhibits abrupt position accumulation or uncharacteristic behavior in the marketplace.[38] Exchanges intentionally set low position accountability levels to enable an

[32]CFTC Regulations 37.600(a) and 38.300 require exchanges to adopt position limitations or position accountability levels for speculators as is necessary and appropriate with respect to contracts for which there are no federal limits. 17 C.F.R. §§ 37.600(a), 38.300.

[33]Haas Testimony at 107.

[34]*Id.*

[35]*Id.*

[36]Testimony of Thomas LaSala, Managing Director and Global Chief Regulatory Officer of Market Regulation, CME Group, Before the CFTC's EEMAC Meeting 107 (Feb. 26, 2015) ("**LaSala Testimony**"). To illustrate the value of position accountability levels and the flexibility they provide for different types of contract months, Thomas LaSala of CME described in his EEMAC testimony various levels of open interest that CME monitors. *Id.* LaSala states that the exchange is interested in traders who hold approximately: (1) 45% of the open interest in the back months; (2) 30%-35% of the open interest in the third to sixth contract months; (3) 20%-25% of the open interest in the second contract month; and (4) 15%-20% of the open interest in the front month. As the spot month approaches, the exchanges continue to scrutinize traders' positions. *Id.*

[37]Haas Testimony at 97-98.

[38]LaSala Testimony Materials, *available at* http://www.cftc.gov/ucm/groups/public/@newsroom/documents/generic/eemac022615_lasala2.pdf.

exchange to gather information in a proactive, timely manner. If an exchange determines that a position may become excessive, the exchange has the authority to prohibit a trader from adding to the position and/or order the trader to reduce the position.[39] In the event that the position does not threaten to disrupt or otherwise harm the integrity of the market, the exchange will maintain a dialogue with the trader to proactively monitor the position.

The position accountability regime is more appropriate for energy markets than the position limit regime because market participants can trade in a greater number of contract months further out the curve without the fear of a regulator bringing a disciplinary action for violating a position limit. By permitting market participants to take a position close to or above position accountability levels, liquidity and price discovery will not suffer and the Commission could continue to monitor the market participant's position and take actions (such as order the market participant to reduce or liquidate the position) as they become necessary or appropriate.

By adopting a position accountability regime outside of the spot month, the Commission would achieve its goals of preventing excessive speculation and market manipulation without compromising liquidity needs and the price discovery function. The Commission would gain a deeper understanding of market dynamics and be afforded a flexible approach to actively review positions by analyzing various factors that cause a market participant to take on a larger-than-normal position.[40] MFA encourages the Commission to impose position accountability levels outside of the spot month instead of position limits to more flexibly achieve its goals without causing harm to the markets. MFA realizes that this approach could require the Commission to issue a rule proposal on position accountability levels. A staged adoption of position limit rules, as suggested above, would provide the Commission with the opportunity to first adopt position limits for spot month contracts and rely on existing exchange position accountability levels outside of the spot month, and study the impact of position limits on the markets while considering the adoption of position accountability levels outside of the spot month.

2. <u>A Position Accountability Regime Would Reduce Compliance Costs for Market Participants and Would Be Less Likely to Impair Liquidity</u>

The Commission should also take into account the not-insignificant costs related to compliance with the position limits regime. This is of particular concern as the compliance costs may deter some market participants from otherwise participating in the futures markets. Fewer market participants in the futures markets could negatively impact market liquidity for *bona fide* hedgers and disrupt the price discovery function of the markets.[41] During the EEMAC Meeting, participants discussed the burden compliance costs would impose on market participants.[42] MFA is concerned that the Commission underestimates the number of affected parties and the

---

[39] *See, e.g.*, CME Rule 560 and ICE Futures U.S. Rule 6.13.

[40] MFA 2014 Comment Letter at 20-23.

[41] *See* Section 4a(a)(3) of the Act; 7 U.S.C. § 6a(a)(3).

[42] Haas Testimony at 91 (describing that market participants are willing to trade over the counter, where they take on counterparty risk, to avoid the high costs associated with trading futures).

costs of compliance with the proposed position limits, and that the potential unintended consequences of the rules will greatly outweigh any purported benefits.

The compliance costs associated with position limits are significantly high, and are disproportionately burdensome for those who are unlikely to ever come close to reaching the limits. MFA members would need to establish monitoring systems to ensure compliance with hard position limits if the Commission chooses to adopt position limits for the spot month and all other months. MFA members' compliance with position limits translates into costly day-to-day and intra-day monitoring of positions in the spot month and outside of the spot month, especially because violating a hard position limit by even one contract can result in disciplinary sanctions. These monitoring challenges are compounded for firms employing numerous traders in multiple locations, or who must aggregate positions with other firms under the Commission's aggregation rules. The costs of compliance with hard position limits could act as a disincentive to trade or hold legitimate positions, resulting in decreased market liquidity and higher transaction costs.

MFA believes that position accountability levels would serve as a less costly and disruptive alternative to position limits. Position accountability levels serve a similar purpose as position limits, but would be less costly for market participants to comply with and, thus, be less likely to negatively impact market liquidity and price discovery. MFA respectfully requests that the Commission compare and weigh the costs-benefits of the proposed position limits regime with a position accountability regime on the markets.

3. The Commission Has the Authority to Impose Position Accountability Levels and Should Exercise This Authority

The Act provides the Commission with the authority and discretion to adopt position accountability levels. The Act authorizes the Commission to determine that position limits outside of the spot month are not necessary or to exempt non-spot months from position limits.[43] Section 4a(a)(1) of the Act sets forth the Commission's broad authority to set position limits as the Commission finds are necessary to diminish, eliminate, or prevent such burden to interstate commerce caused by excessive speculation that causes sudden or unreasonable fluctuations or unwarranted changes in the price of such commodity.[44] However, if the Commission makes a necessity finding for all energy markets, the Commission should exempt energy contracts that are outside of the spot month from the hard position limits requirement in accordance with the explicit provisions of Section 4a(a)(7) of the Act.[45]

By determining that position limits are not necessary for contracts outside of the spot month or exempting such contracts from the proposed position limits regime, the Commission may apply other more appropriate methodologies to prevent excessive speculation outside of the

[43]Sections 4a(a)(1), 4a(a)(7) of the Act; 7 U.S.C. §§ 6a(a)(1), 6a(a)(7).

[44]Section 4a(a)(1) of the Act; 7 U.S.C. § 6a(a)(1).

[45]Section 4a(a)(7) provides that "[t]he 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." 7 U.S.C. § 6a(a)(7).

spot month. Section 4a(a)(2) of the Act provides that "the Commission shall by rule, regulation, or order establish limits on the amount of positions, ***as appropriate***, other than bona fide hedge positions, that may be held by any person."[46] Section 8a(5) of the Act authorizes the Commission "to make and promulgate such rules and regulations as, in the judgment of the Commission, are reasonably necessary to effectuate any of the provisions or to accomplish any of the purposes of this chapter."[47] For the reasons set forth above in Section C.1, a position accountability regime is more appropriate for non-spot month contracts in the energy markets. MFA respectfully requests that the Commission exercise its authority under Sections 4a(a)(2) and 8a(5) of the Act to the Commission's consideration of an appropriate position limits regime applicable to energy contracts outside of the spot month.

III. CONCLUSION

MFA shares the Commission's desire to preserve and enhance the integrity of our markets. However, MFA is concerned that the Commission needs further data and to review its methodology in order to set appropriate position limits. We are concerned that the proposed position limits are miscalibrated and have been set too low. In setting position limits, the Commission should consider market-specific methodology and data, given the unique characteristics and traits of the energy markets. We are not convinced that position limits are necessary outside of the spot month for energy markets, and believe the Commission should conduct further analysis to ensure that such limits are necessary, appropriate, and if implemented, that they would not disrupt markets and the ability of market participants to hedge commercial risk.

MFA recommends that the Commission adopt position limit through a two-phase approach to decrease the risk of market disruption by affording the Commission better data on which to base non-spot month position accountability levels or position limits. MFA respectfully urges the Commission to consider the benefits of implementing position accountability levels instead of position limits outside of the spot month. Position accountability levels serve a similar function as position limits, but in a manner that would provide the Commission and market participants with greater flexibility to adjust to changing market conditions. It would also be significantly less costly from a compliance perspective; and less likely to harm market liquidity and price discovery. Nevertheless, to the extent the Commission determines to implement position limits for non-spot months, we recommend that it adopt such limits in the second phase of a two-phase approach.

[46] Section 4a(a)(2) of the Act; 7 U.S.C. § 6a(a)(2) (emphasis added).

[47] Section 8a(5) of the Act; 7 U.S.C. § 12a(5).

We appreciate the opportunity to offer comments to the February 2015 Notice. We would be happy to discuss our comments or any of the issues raised by the Commission's position limits proposal at greater length with the Commission or its staff. If the staff has any questions, please do not hesitate to call Jennifer Han, Associate General Counsel, or the undersigned at (202) 730-2600.

Respectfully Submitted,

/s/ Stuart J. Kaswell

Stuart J. Kaswell
Executive Vice President & Managing Director, General Counsel
Managed Funds Association

cc:

The Honorable Chairman Timothy Massad
The Honorable Commissioner Mark Wetjen
The Honorable Commissioner Sharon Bowen
The Honorable Commissioner J. Christopher Giancarlo