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February 28, 2017

Via Electronic Submission

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

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

Dear Mr. Kirkpatrick:

The Futures Industry Association ("**FIA**") welcomes the opportunity to provide the Commodity Futures Trading Commission ("**Commission**" or "**CFTC**") with comments and recommendations in response to the Commission's reproposed rules concerning position limits for derivatives (the "**Reproposal**"). FIA's primary and associate members, their affiliates, and their customers actively participate in the listed and over-the-counter ("**OTC**") derivatives markets as intermediaries, principals, and users.[1] For the reasons set forth herein, FIA urges the Commission to withdraw its current rulemaking and undertake an empirical analysis to determine when speculative activity becomes excessive. In the alternative, FIA requests that the Commission adopt FIA's recommended revisions to the Reproposal before issuing final position limit rules.

FIA has provided the Commission with multiple and extensive comments on its proposed position limits rules during the past six-plus years.[2] FIA appreciates the changes that the Commission has made in its Reproposal in response to the comments of FIA and other market participants. FIA also supports the Commission's decision to re-propose position limits

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[1] FIA is the leading global trade organization for the futures, options and centrally cleared derivatives markets, with offices in 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 member firms play a critical role in the reduction of systemic risk in global financial markets.

[2] FIA's letter to the Commission, dated January 22, 2015, included a summary of FIA's position limit comment letters as of that date. FIA subsequently submitted comment letters on March 30, 2015, July 13, 2016, and September 29, 2016. FIA incorporates these prior comments by reference herein.

rules in order to provide the Acting Chairman, new Commissioners, CFTC Staff, and the public with an opportunity to take a fresh look at the important issues raised by federal position limits. In particular, FIA encourages the Commission to revisit key aspects of the Reproposal, including whether position limits are necessary for each Referenced Contract, whether position accountability levels are more appropriate than hard limits for non-spot months, the scope of the definition of *bona fide* hedging position and enumerated hedging positions, the necessity and burden of the multiple reporting requirements, as well as certain other aspects of the proposed rule.

Despite its improvements, the Reproposal at bottom remains an overbroad solution in search of a hypothetical problem. FIA urges the Commission to identify and re-examine the problem it is trying to solve and then, only if necessary, design a rule to address the specific problem. In Section 4a(a)(1) of the Commodity Exchange Act ("**CEA**"), as amended, Congress stated that "excessive speculation … causing sudden or unreasonable fluctuations or unwarranted changes in the price of [commodity futures and swaps contracts] is an undue and unnecessary burden on interstate commerce." Therefore, Congress directed the Commission to establish limits on "the amounts of trading which may be done or the positions which may be held by any person" as the Commission finds are "necessary to diminish, eliminate or prevent" that undue burden. Before attempting to find that position limits are necessary to prevent excessive speculation, the Commission necessarily must first define when speculative activity becomes excessive; something it has never done.

Rather than focusing on preventing excessive speculation, the Reproposal is directed primarily at preventing any purported speculation that may be occurring in the guise of *bona fide* hedging. The Commission's singular focus on such hidden speculation has resulted in the Commission proposing an overly narrow and insufficiently flexible definition of *bona fide* hedging that does not recognize legitimate risk-reducing commercial activities. Furthermore, the Reproposal creates needless and burdensome reporting obligations that fall principally on hedgers, rather than speculators. This construct ultimately makes it more difficult to conduct *bona fide* and other risk-reducing hedging activity that is critical to the commodity markets and to sound risk management. Because the Reproposal does not define when speculation becomes excessive, it is not designed to deter "excessive speculation" that causes "sudden or unreasonable fluctuations or unwarranted changes in the price of [commodity futures and swaps contracts]" that place "undue and unnecessary" burdens on interstate commerce in such commodities.

I. Summary of Comments

FIA recommends, consistent with its prior comments, that the Commission conduct an empirical review of current market data to determine whether position limits are necessary.

This review should determine the point at which speculation becomes excessive with respect to each Referenced Contract for which the CFTC intends to propose position limits.

If the Commission decides to move forward with position limits without conducting an empirical analysis, FIA recommends that the Commission:

- Only adopt spot month position limits for Referenced Comments.
- Adopt spot month position limits in phases starting with exchange-traded Referenced Contracts, and thereafter, OTC Referenced Contracts.
- Publish a comprehensive list of Referenced Contracts prior to imposing Commission-set spot month limits.
- Establish higher spot month limits for cash-settled Referenced Contracts because they are much less susceptible to manipulation. Furthermore, the Commission should not condition higher limits for cash-settled Referenced Contracts on a market participant not having a position in the physical delivery Referenced Contract.
- Withdraw the proposal for non-spot month limits and analyze whether (1) non-spot month limits are necessary; and (2) non-spot month accountability levels are more appropriate than hard limits.
- To the extent that the Commission decides in a later rulemaking that non-spot month limits are necessary, it should adopt accountability levels in lieu of hard limits. The Commission should phase-in accountability levels starting with exchange-traded Referenced Contracts and, thereafter, include OTC Referenced Contracts.
- Provide a transition period of not less than twelve months after the Commission adopts final position limits rules to allow market participants to come into compliance with the final rules.
- Simplify the grandfathering relief for pre-existing positions by providing the same relief for all positions established in good faith prior to the effective/compliance date of a position limit.
- Adopt a blanket exception for positions that hedge financial exposure because they are risk reducing and not speculative. Alternatively, the Commission should authorize the exchanges to grant risk management exemptions from speculative position limits.

- Provide risk managers with the flexibility to manage commercial risk by defining *bona fide* hedging position in a manner consistent with the statutory text and commercial practice. The Commission should allow market participants to:
    - Evaluate risk at business line, regional, legal entity, or aggregated group level, depending upon the unique circumstances of their business.
    - Hedge risk on a net or gross basis.
    - Hedge all, or portions, of a cash portfolio, so long as the derivative positions reduce the risk of a cash portfolio.
    - Hedge price risk that arises from other risks without applying to an exchange for a non-enumerated hedge exemption.
- Expand the list of enumerated *bona fide* hedging positions to incorporate common commercial hedging strategies.
- Create regulatory certainty for non-enumerated hedge and spread exemptions. The Commission should review exchange determinations for non-enumerated hedge and spread exemptions through the rule enforcement review process. Alternatively, if the Commission intends to conduct a review as the exchanges grant the exemptions, there should be a finite period of time within which the Commission must review and overturn an exchange determination.
- Remove the requirement that a Referenced Contract (or a contract in the same underlying commodity) must be actively traded on an exchange in order for the exchange to grant non-enumerated hedge or spread exemptions.
- Promote liquidity for *bona fide* hedgers by expanding the pass-through swap exemption to cover market participants who enter into a swap with a liquidity provider who is offsetting the risk of a swap with a *bona fide* hedging counterparty.
- Eliminate the *bona fide* hedging reporting forms and instead allow market participants to report information annually as allowed under existing exchange rules. FIA's proposed annual process provides the Commission with similar data to the data required by the forms, but significantly reduces the compliance burden.
    - To the extent that the Commission retains the reporting forms, the Commission should (1) remove the duplicative Form 704 and associated

application requirements for hedges of anticipated exposure; and (2) consolidate Forms 204 and 604 into a single Form and eliminate any daily filing requirements.

- Eliminate the daily reporting requirements for Form 504 because daily reporting of cash positions is technologically impractical and costly, and provides little surveillance benefit to the Commission.

- Conform the rule text for spread exemptions with the language in the preamble to make clear that the list of spread exemptions in the rule is illustrative, and not exhaustive. In addition, the list of common examples of spread positions should include location spreads.

- Provide flexibility for designated contract markets ("**DCMs**"), consistent with DCM Core Principle 5, to adopt hard limits, accountability levels, or no limits for non-Referenced Contracts.

- Reconsider the costs and benefits associated with various aspects of the Reproposal because the Commission did not estimate, or significantly underestimated, the costs associated with compliance.

II. FIA Supports Many of the Modifications Made in the Reproposal

Before addressing specific aspects of the Reproposal that FIA believes should be reconsidered or modified, it is appropriate to acknowledge the changes that the Commission made to the proposed rules in response to comments submitted by FIA and other market participants. These changes significantly improve prior versions of the proposed rules. In particular, FIA supports:

- Harmonizing the length of the spot month for CFTC and exchange-set limits;

- Accepting exchange estimates of deliverable supply for spot month limits.

- Delaying any obligation for a DCM or swap execution facility ("**SEF**") to establish limits on swaps until the exchange has access to sufficient swap position information.

- Delegating to the exchanges the authority to recognize non-enumerated *bona fide* hedge or spread exemptions from federal limits, including during the last five days of trading. In addition, FIA supports:

- Clarifying that exchanges may grant non-enumerated hedge exemptions to override the last five-days restriction on certain enumerated hedges;

- Eliminating the requirement that market participants provide three years of cash-market exposure when applying for a non-enumerated hedge exemption; and

- Authorizing the exchanges to adopt rules that allow market participants to apply for a non-enumerated hedge or spread exemption in advance of, or within a reasonable period after, exceeding a position limit.

- Removing the incidental test and orderly trading requirement for *bona fide* hedging positions.

- Removing the quantitative test for cross-commodity hedges.

- Excluding trade options from the definition of Referenced Contract, and allowing them to serve as a basis for a *bona fide* hedge.

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

- Revising the approach to option deltas, which, consistent with current exchange practice, provides market participants one business day to liquidate positions in excess of the limits due to an option assignment; and

- Clarifying that location basis contracts are excluded from exchange-set limits.

III. The Commission has Not Found that Position Limits are Necessary or that the Proposed Levels are Appropriate as Mandated by the CEA

FIA respectfully submits that the CFTC's necessity finding is insufficient under the CEA.[3] At a minimum, CEA Section 4a(a)(1) requires the CFTC to determine that position limits are necessary and appropriate to diminish, eliminate, or prevent the undue burdens of excessive speculation in each Referenced Contract. Although the Commission made an "alternative finding" that position limits are necessary, the finding is not based upon an empirical review of

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[3] *See also* FIA Letter to CFTC, Section VI (Mar. 18, 2010); FIA Letter to CFTC, Section II, V (Mar. 25, 2011); FIA Letter to CFTC, Section II, VI (Jan. 17, 2012); FIA Letter to CFTC, Section II, III (Feb. 7, 2014); FIA Letter to CFTC, Section I (July 31, 2014); FIA Letter to CFTC, Section I (Jan. 22, 2015); FIA Letter to CFTC, Section I, II (Mar. 30, 2015).

current market data for each Referenced Contract. Thus, the Commission could not have reasonably found that any proposed limit is either necessary or appropriate in view of the statute.[4]

The Commission's "finding" that position limits are necessary relies upon historical examples, some of which are several decades old. The Commission did not examine current market data to determine whether excessive speculation exists in a particular market, or the point at which speculation could become excessive in a particular market. Furthermore, the Commission based its decision to propose limits for 25 Referenced Contracts on their being highly traded rather than those contracts being more susceptible to excessive speculation.[5] Without an evaluation of current market data, and without an investigation to determine the point at which speculation becomes excessive for a particular market, the Commission cannot determine that the limits proposed are necessary or that the levels of the limits are appropriate to combat excessive speculation.

FIA urges the Commission to reevaluate whether position limits are necessary. As part of this analysis, the Commission should define the point at which speculation becomes excessive in a particular market. Absent an objective framework for defining and measuring excessive speculation, the CFTC cannot articulate a rational basis for its claim that CFTC-set position limits will diminish, eliminate, or prevent the undue burden on interstate commerce in Referenced Contracts caused by excessive speculation.

IV. If the Commission Moves Forward with Limits for Futures and Swaps, the Commission Should Only Adopt Spot Month Limits

As FIA previously has commented, if the Commission moves forward with position limits final rules without an empirical finding that limits are necessary, it should only address spot month limits for Referenced Contracts. The Commission should not impose federal non-spot month limits because, as discussed below, the deferred months of certain Referenced Contracts have less liquidity than the prompt months, so deferred month limits may have a greater adverse impact than limits during the spot month.

In order to provide an efficient and technologically practicable transition to federal spot month limits for market participants, the exchanges and the Commission, FIA recommends that the Commission phase-in federal spot month limits over time.

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[4] Reproposal at 96716.

[5] Reproposal at 96852-53 (The Commission selected the 25 core referenced futures contracts "on the basis that such contracts: (1) have high levels of open interest and significant notional value; or (2) serve as a reference price for a significant number of cash market transactions.").

A. The Commission Should Set Spot Month Limits in Phases Starting with Exchange-Traded Futures Referenced Contracts, and Thereafter, OTC Referenced Contracts

FIA recommends that any federal limits on spot-month positions start with combined limits across exchange-traded futures Referenced Contracts. Market participants already have experience complying with exchange-set spot month limits in the agricultural, metals, and energy futures markets. By enabling market participants to rely on their prior experience complying with exchange-set spot month limits, the Commission will reduce the costs and burdens that market participants will incur as they prepare to comply with federal spot-month limits that apply across exchange-traded futures Referenced Contracts. Phasing in federal spot month limits also will give the Commission time to develop systems to monitor compliance with a reasonably circumscribed set of limits. Market participants and the Commission will benefit from that experience as they prepare for phase two spot-month limits on OTC Referenced Contracts.

During the second phase, the Commission should implement federal spot-month limits for OTC Referenced Contracts. Imposing limits on OTC Referenced Contracts will be a fundamental and material change to the regulation of the swaps market. Although market participants have the ability to evaluate their swap portfolio(s) from a risk perspective, they typically have not, in the ordinary course, converted swap positions into futures-equivalent positions. As the Commission is aware, the conversion of swaps into futures-equivalents is a time consuming and difficult process.[6] Furthermore, market participants will need to invest considerable information-technology resources to extract data from different and often incompatible trade capture systems so they can track futures and swaps subject to a limit.

In light of the expected difficulty for market participants to monitor OTC positions, and the additional resources necessary for the Commission to surveil OTC positions subject to a federal limit, the Commission should phase-in limits on OTC Referenced Contracts over time. FIA recommends that the Commission consider the specific time period to implement phase two spot month limits on OTC Referenced Contracts after the Commission has some experience administering federal spot month limits in phase one.

B. Prior to Imposing Spot Month Limits, the Commission Should Publish a Comprehensive List of Referenced Contracts Subject to Federal Speculative Position Limits

In order to assist market participants in complying with spot month position limits, the Commission should publish a list of contracts that are subject to limits. FIA recommends that,

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[6] *See* Position Limits for Derivatives, 78 Fed. Reg. 75680, 75734 (Dec. 12, 2013).

prior to each position limits phase, the Commission publish a comprehensive list of Referenced Contracts subject to limits. For example, prior to establishing spot month limits for exchange-traded futures Referenced Contracts, the Commission should publish a comprehensive list of the exchange-traded futures Referenced Contracts that are subject to federal spot month limits. Then it should publish a list of OTC Referenced Contracts that are subject to federal spot month limits.

FIA appreciates the fact that, in connection with the Reproposal, the CFTC Staff published a workbook with a non-exhaustive list of Referenced Contracts. However, for each contract that is not on the current list, market participants must make individual and difficult determinations about whether the particular commodity derivative contract will be subject to federal limits. This categorization process will impose significant costs across the industry and likely will lead to inconsistent determinations by market participants. To reduce regulatory uncertainty, the Commission should publish a comprehensive list and, when necessary, update it to address new exchange-traded and OTC Referenced Contracts.

C. Spot Month Limits for Cash-Settled Referenced Contracts Should be Higher than the Limits for Physical Delivery Referenced Contracts

The Commission proposes the same spot month limits for cash-settled Referenced Contracts as for physical delivery Core Referenced Futures Contracts with one exception: the proposal for higher limits for cash-settled natural gas Referenced Contracts, provided that a participant does not hold a position in the physical delivery Core Referenced Futures Contract during the spot month (referred to as the "conditional limit"). If the Commission moves forward with spot month limits, FIA recommends that the Commission set higher spot month limits for all cash-settled Referenced Contracts than for physical delivery Referenced Contracts because, as the Commission has acknowledged previously, they are much less susceptible to excessive speculation or manipulation.[7]

As FIA has commented previously, the Commission should adopt higher limits for cash-settled contracts without imposing a condition that the participant not hold a position in the physical delivery Referenced Contract. The Commission has observed that the conditional limit may prevent a market participant from manipulating the price of a physical-delivery contract to benefit cash-settled positions.[8] There is no empirical basis for presuming that this is a frequent practice or that it is even possible, absent fraud, to manipulate open markets for the sustained

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

[8] *See* Position Limits for Derivatives, 78 Fed. Reg. 75680, 75737 (Dec. 12, 2013).

period that would be necessary for such a scheme to achieve its assumed objective.[9] Furthermore, there is no basis for presuming that holding a single position, or even multiple positions, below the speculative limit in a physical-delivery Referenced Contract constitutes "excessive speculation" that the Commission is authorized to deter. Rather than setting a conditional position limit, the Commission should rely on its broad anti-manipulation authority to address concerns about manipulation of a physical delivery contract to benefit a cash-settled position. The Commission's manipulation authority is a more precise, appropriate and targeted tool than position limits for preventing manipulative activity.

FIA also notes that the Commission has not found that setting position limits for cash-settled contracts at the same level as physical delivery contracts is necessary to deter excessive speculation. Absent such a finding, the Commission should apply its prior guidance that cash-settled contracts are less susceptible to manipulation and set higher limits for cash-settled Referenced Contracts.

V. The Commission Should Reconsider Whether Non-Spot Month Limits are Necessary and Whether Accountability Levels are More Appropriate Than Hard Limits

The Commission should withdraw the proposed hard non-spot month limits for Referenced Contracts.[10] In a separate rulemaking, the Commission should address whether non-spot month position limits are necessary with respect to each Referenced Contract. As the Commission is aware, there is limited liquidity in the deferred months for certain Referenced Contracts compared to the prompt months.[11] Without a finding that non-spot month limits are necessary for each Referenced Contract, the Commission runs the risk that, contrary to its statutory mandate, it will impose limits that unduly restrict liquidity for *bona fide* hedgers, negatively impact the price discovery function, or both.

If the Commission imposes hard non-spot moth limits, market participants may elect to adjust their deferred month positions to stay sufficiently below the all-months-combined position limits.[12] They may, for example, choose to focus their trading in contract months in

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[9] FIA also notes that although the Commission has limited experience with the conditional limit for natural gas contracts traded on an exchange, the Commission does not know what the impact of the conditional limit will be if OTC swaps are also subject to limits.

[10] *See* FIA Letter to CFTC, Section II (Mar. 30, 2015).

[11] During the February 26, 2015 CFTC Energy and Environmental Advisory Committee ("**EEMAC**") meeting, both CME and ICE highlighted the reduced liquidity in the deferred trading months. *See e.g.,* EEMAC Panel I, Presentation of Intercontinental Exchange, p. 8 (Henry Hub Participation as of Feb. 20, 2015) available at http://www.cftc.gov/ucm/groups/public/@aboutcftc/documents/file/eemac022615_icemarkets1.pdf.

[12] Market participants may decide to stay below a percentage of an applicable limit, rather than below the limit itself, as part of their process for monitoring their positions.

more liquid points of the forward curve and exit positions in more deferred parts of the curve. This would have the effect of reducing liquidity for *bona fide* hedgers in less liquid points in the forward curve.

As part of its analysis to determine whether non-spot month limits are necessary, the Commission should study whether accountability levels are a more appropriate form of limit outside the spot month. FIA's prior comments have demonstrated that the Commission has the authority in CEA Section 4a(a) to propose and adopt accountability levels as a form of limit in lieu of hard non-spot month limits.[13] Alternatively, the Commission has the authority under CEA Section 4a(a)(7) to adopt accountability levels by exempting non-spot month positions from hard position limits.[14]

Both hard limits and accountability levels operate as a form of limit. In an accountability framework, if a market participant exceeds an accountability level, an exchange (or the Commission if it sets the level) may request that a participant explain the nature of its positions and justify the need for a position at a particular level. Upon review, the exchange may direct the participant to reduce its positions. The main difference between an accountability level and a hard limit is that the accountability level is a flexible limit based upon a dynamic review of a market participant's positions in the context of their particular cash market activity and the particular Referenced Contract market. The exchanges have a long and successful history of administering accountability levels outside the spot month.[15] The process for administering accountability levels has served the exchanges, end-users, and market participants well by preserving liquidity and, thus, promoting the price discovery function of the derivative markets.

A. If the Commission Moves Forward with Non-Spot Month Limits, it Should Phase-in Accountability Levels Starting with Exchange-Traded Futures Referenced Contracts, and Thereafter, OTC Referenced Contracts

As noted above, FIA recommends that the Commission address any limits on non-spot month positions as part of a later and separate rulemaking. To the extent the Commission determines that limits outside of the spot month are necessary, the Commission should phase-in non-spot month accountability levels over time starting with non-spot month Exchange-Traded Futures Referenced Contracts. As with spot month limits, market participants have

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[13] *See* FIA Letter to CFTC, Section III.A (Mar. 30, 2015).

[14] *Id.*

[15] *See, e.g.*, EEMAC Meeting, Committee Testimony, pp. 67, 73, 82, 96 & 107 (Feb. 26, 2015). In addition, the Commission's Staff also has acknowledged the proven track record of accountability levels in the exchange rule enforcement review process. *See e.g.*, Market Surveillance Rule Enforcement Review of the New York Mercantile Exchange and the Commodity Exchange, CFTC Division of Market Oversight, p. 9, (Oct. 11, 2016) available at http://www.cftc.gov/idc/groups/public/@iodcms/documents/file/rernymex_comex101116.pdf.

experience trading in the context of exchange-set accountability levels outside of the spot month. This prior experience will benefit market participants as they prepare to comply with federal non-spot accountability levels.

The phased approach for non-spot month accountability levels should follow a track similar to the phased approach for spot month limits. That is, the Commission should implement accountability levels starting with exchange-traded Referenced Contracts and thereafter implement accountability levels for OTC Referenced Contracts. As noted above, prior to each phase the Commission should publish a comprehensive list of Referenced Contracts subject to limits.[16]

VI. The Commission Should Provide a Sufficient Transition Period of No Less than Twelve Months and Simplify the Grandfathering Provisions

FIA appreciates the Commission's consideration of FIA's recommendation of an extended transition period before market participants must comply with final position limits rules. FIA previously recommended a transition period of nine months after the exchanges adopt rules implementing the Commission's final position limits rules (*e.g.*, nine months after the exchanges adopt rules to apply for a non-enumerated hedge exemption).[17] Because it is unclear when or even if the exchanges will adopt implementing rules, FIA is modifying its original recommendation to a transition period of twelve months after the Commission adopts final position limits rules.[18] A twelve-month transition period should provide market participants with sufficient time to develop, test and deploy systems, policies, procedures, and controls that are reasonably designed to track positions subject to a limit and to comply with the Commission's new proposed reporting requirements, preferably modified in accordance with FIA's recommendations.

A. The Proposed Compliance Date is Technologically Impractical

The Reproposal proposes a compliance date of January 3, 2018. Although FIA appreciates the Commission coordinating with its European counterparts on the implementation of position limits regulations, the January 3, 2018 compliance date no longer will provide market participants with sufficient time to prepare after the issuance of the

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[16] *Supra* at IV.B.

[17] *See* FIA Letter to CFTC, Section XIX (July 13, 2016).

[18] The twelve-month period from the final rule should provide a similar timeframe compared to FIA's original suggestion of nine months after the adoption of exchange rules.

Commission's final rules.[19] Given the complexity and length of the Reproposal, the expected arrival of new commissioners, and the scores of expected comments, the Commission likely will not issue final rules until the third or fourth quarter of 2017. Such a timeline would only provide market participants with one or two months, at best, to come into compliance with an incredibly complex set of rules.

It would be technologically impractical at this point for the Commission to attempt to align its position limits compliance date with the January 3, 2018 compliance date in Europe. Market participants will need considerable time to evaluate the impact of final rules and to develop the automated systems necessary to track positions and comply with any reporting requirements. For many market participants, the implementation effort will require the development of systems that collect and sort data from disparate systems across the globe and that enable the review and vetting of data for accuracy and completeness. The ability of market participants to design, develop and test automated monitoring and control systems to comply with final position limits rules will be delayed by industry standard end-of-year freezes on new coding imposed by the information-technology departments of many market participants. For all of these reasons, if the Commission adopts new federal position limits, it should provide market participants with at least a twelve month period after issuance of final rules to comply with the rules.[20]

B. The Grandfathering Relief for Pre-Existing Positions Does Not Reduce the Amount of Time that Market Participants Need to Prepare for Final Rules

In the Reproposal, the Commission decided not to provide an extended transition period because the need for a delay "may be mitigated by the grandfathering provisions in the Reproposal."[21] The grandfathering provisions for pre-existing positions do not decrease the amount of time needed for market participants to prepare for final position limit rules. Rather, the grandfathering provisions address only one aspect of the position limits rules that market participants must incorporate into their overall compliance program.

C. The Commission Should Simplify the Grandfathering Relief for Pre-Existing Positions

FIA recommends that the Commission simplify the grandfathering provisions in order to reduce the burden of complying with any final rules. As proposed, the Commission divides the

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[19] In its prior request to align the Commission and European position limits implementation dates, FIA also highlighted the need for an extended transition period. *See* FIA Letter to CFTC (Sept. 29, 2016); and FIA Letter to CFTC, Section XIX (July 13, 2016).

[20] FIA notes that during the compliance period, current CFTC and exchange-set limits will remain in place.

[21] *See* Reproposal at 96728.

grandfathering relief into several categories that depend upon the time of entering into the transaction or position and whether a position results from a futures contract or a swap. For example, the Reproposal creates separate grandfathering categories for (1) swaps entered before the enactment of Dodd-Frank; (2) swaps entered before 60 days after the CFTC adopts final rules; and (3) futures and swaps entered before the compliance date of January 3, 2018.

The complex proposed grandfathering structure will add significant costs to comply with final rules. For example, market participants will need to develop systems that classify positions into the various categories of relief and then evaluate the overall impact across each category. Accordingly, FIA recommends that the Commission establish a single effective/compliance date that is twelve months after the Commission adopts final rules. Positions established in good faith before the effective/compliance date should be eligible for the same grandfathering relief, *i.e.*, the positions are not subject to limits, but may be used to net against positions established after the effective/compliance date.

VII. The Commission Should Not Impose Speculative Position Limits on Risk-Reducing Positions

There are many types of risk-reducing futures and swap positions that, although not *bona fide* hedging positions, are not speculative positions. Derivatives positions that reduce risk are not speculative and, therefore, should not be subject to speculative position limits. Rather than seeking to impose limits on non-speculative positions, the Commission should adopt a blanket exemption for risk-reducing positions in agricultural and exempt commodities. Alternatively, the Commission should, at a minimum, authorize the exchanges to grant risk management exemptions for risk-reducing positions.

As FIA notes above, the Commission should refocus its rulemaking to prevent excessive speculation. The Reproposal takes an over-broad approach by classifying all positions that do not meet the definition of a *bona fide* hedge position as speculative. The Commission's proposal is not consistent with the CEA's limitation on the Commission's authority to set limits only on speculative positions if necessary to prevent "excessive *speculation*." If a position is not speculative, it cannot contribute to excessive speculation and the Commission has no authority to subject it to limits. The Commission appears to acknowledge that hedging financial risk is not speculation because the Commission authorizes the exchanges to adopt risk-management exemptions for excluded commodities.[22] The same hedging activity in the agricultural and exempt commodity markets is not speculative, and should be eligible for the same exemption available for excluded commodities.

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[22] *See* proposed CFTC Rule 150.5(c)(5).

Section 3(a) of the CEA describes speculative transactions as "transactions in which a market participant assum[es] price risks." The Commission also stated in the Reproposal that "speculators would tend to be compensated for assuming the price risk[…]."[23] The Commission relies upon a similar definition of speculation in other rules.[24] The hedging strategies described below are designed to reduce risk; they are not speculative because the positions are not put on to "take an outright view on market direction."

Many market participants use futures and swap contracts to hedge exposure to OTC commodity index swaps and commodity-linked notes. This hedging activity reduces a participant's risk to changes in the price of a referenced commodity. Using futures and swaps to hedge commodity index contracts and commodity-linked notes makes a participant price-neutral, which is the same result achieved by *bona fide* hedging positions.[25] These risk-reducing positions are not "speculative," even if they do not meet the definition of a *bona fide* hedge.

In addition to hedging commodity index contacts and commodity linked notes, many market participants use futures and swap contracts to hedge exchange-traded fund ("**ETF**") price change exposure. This hedging activity reduces a participant's risk to changes in price of an ETF and is designed to make the participant price-neutral in the same way as *bona fide* hedging of cash market activity. Market participants who use derivatives markets to hedge ETF exposure do not acquire the derivative position to speculate on changes in price. Moreover, their ETF hedging activity provides liquidity to the futures markets, which benefits commercial end-users who need to hedge the risks that they incur in their commercial operations. By exempting non-speculative risk-reducing Referenced Contract positions from position limits, the Commission would increase liquidity for commercial hedgers and improve the efficiency of the markets.

CEA Section 4a(a)(7) provides the Commission with broad authority to exempt classes of contracts from position limits requirements. The Commission should use this exemptive authority to adopt a blanket exemption for risk-reducing positions. Alternatively, FIA requests that the Commission exercise its exemptive authority to permit the exchanges to grant risk management exemptions from federal limits for non-speculative hedging transactions. The

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[23] Reproposal at fn. 254.

[24] 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).

[25] Reproposal at 96745.

exchanges have decades of experience administering risk management exemptions. As it has for non-enumerated hedge and spread exemptions, the Commission can provide guidance to the exchanges for purposes of granting risk management exemptions from federal limits that are consistent with the provisions of CEA Section 4a.

VIII. The Definition of *Bona Fide* Hedging Positions Should Provide Risk Managers with Sufficient Flexibility to Manage Commercial Risk

FIA appreciates the Commission's revisions to its initial proposed definition of *bona fide* hedging positions in order to provide more flexibility to *bona fide* hedgers. However, the definition in the Reproposal is still too proscriptive and too difficult for risk managers to administer in practice. To alleviate the administrative burdens and provide risk managers with the flexibility to manage risks that arise in the conduct of a commercial business, FIA recommends that the Commission make the following modifications to the proposed definition of *bona fide* hedging positions.

A. The Proposed Interpretation of the Economically Appropriate Test is Unnecessarily Restrictive

The Commission's proposed interpretation of the requirement that a *bona fide* hedge be "economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise" goes beyond the language in CEA Section 4a(c)(2) and is inconsistent with long-standing commercial risk management practices. Effectively, the Commission proposes to create an inflexible, one-size-fits-all approach to managing risk that substitutes its judgment for the judgment and experience of commercial enterprises that need flexibility to manage the many risks that they incur as part of their normal business activities. FIA recommends that the Commission make several changes to its guidance that a market participant must hedge risk on a net basis across all aggregated entities, unless a limited exception applies.

1. Market Participants Should Have the Flexibility to Evaluate Risk Based Upon Their Commercial Judgment

The Commission should eliminate the requirement that market participants evaluate risk within the context of an aggregated group of entities. Because the economically appropriate test in CEA Section 4a(c)(2) does not require this methodology to evaluate risk, the Commission should provide market participants with the flexibility to evaluate risk based upon their commercial judgment and particular risk management needs. For example, market participants should be able to view risk on a business line, regional, legal entity, or aggregated group level, depending upon the unique circumstances of their business.

Absent this flexibility, many market participants may be forced to centralize risk into a single hedging affiliate. Although some market participants may utilize a central hedging affiliate model, the Commission's rules should not force market participants to manage risk in this manner. Rather, the rules should provide risk managers with the flexibility to manage risk in a manner most appropriate for their business. Furthermore, in order to provide a mechanism for participants to hedge risk separately for different affiliates, the Commission should continue to permit legal entities within an aggregated group to rely on separate *bona fide* hedge exemptions, rather than requiring them to manage *bona fide* hedge exemptions on an aggregated basis.

2. Market Participants Should Have the Flexibility to Hedge Risk on a Net or Gross Basis

The proposed restriction on gross hedging only to circumstances where "net hedging does not measure all risk exposures" of an aggregated enterprise is inconsistent with the manner in which many commercial businesses manage the risks that they incur in their business operations. Market participants that hedge on a portfolio basis, as opposed to hedging across all aggregated entities, would need to develop new systems and processes to net exposures. Furthermore, as FIA and others have pointed out in the past, the Commission previously has provided market participants with the flexibility to hedge on a net or gross basis.[26] 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 of a commercial enterprise."

3. Market Participants Should Have the Flexibility to Hedge Portions of a Cash Portfolio

The Commission should allow market participants to hedge portions of an underlying portfolio of cash market positions, provided that the hedging activity reduces risk within the specified portfolio. FIA believes that the Commission misunderstood its prior comment on hedging portions of a portfolio.[27] To the extent that a hedging position increases risk in a particular portfolio, FIA agrees that the positon should not qualify as a *bona fide* hedge. However, market participants still should be authorized selectively to hedge exposure *provided*

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[26] *See* Administrative Determination No. 167 (Feb. 13, 1959) ("In other words, there is no requirement in the statute that restricts a merchant or processor to hedging his net position only.").

[27] *See* Reproposal at 96747. FIA does not believe that a hedging strategy that increases risk for a portfolio should qualify as a *bona fide* hedge position.

that the hedge positions are economically appropriate to the reduction of risks for a particular hedge portfolio.[28]

4. Market Participants Should Not Need to Apply for a Non-Enumerated Hedge to Manage Price Risks that Arise from Other Types of Risk

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 credit risk, weather risk, sovereign risk, government policy risk (*e.g.*, an embargo), and other risks that affect price. FIA appreciates the Commission's comment in the preamble that the exchanges may consider additional risks as part of a non-enumerated hedge, provided price risk arises from the other types of risk.[29] However, this proposed process is not practical because risk is dynamic and changes from day-to-day. Risk managers consider many risks as they arise and hedge accordingly. For example, a market participant may need to factor in the impact on price due to a threat of an embargo for an energy commodity, the proliferation of disease in an agricultural commodity, or credit risk.[30] Price risk arises from each of these risks, but it is not practical for a market participant to apply for a non-enumerated hedge exemption each time a new risk arises. Rather, the Commission should develop a flexible framework for its *bona fide* hedge definition that recognizes hedges designed to manage price risk that arise from other types of risks.

B. The Commission Should Expand the List of Enumerated Hedges

As FIA repeatedly has commented in the past, the Commission should expand the list of enumerated hedging positions to permit common risk-reducing practices, including the ten examples provided by the Working Group of Commercial Energy Firms in their January 20, 2012 comment letter. In particular, the Commission should recognize hedging of:

- Anticipated commitments to buy or sell a commodity;
- Irrevocable fixed-price bids/offers;
- Calendar-month average contracts; and
- Physical delivery *bona fide* hedging positions held during the spot month.

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28 *See* CEA Section 4a(c)(2)(A)(ii).

29 *See* Reproposal at 96746.

30 *See e.g.*, Commodity Markets Council Letter to CFTC (Mar. 28, 2015); Morgan Stanley Letter to CFTC (Feb. 10, 2014).

FIA appreciates that the Reproposal authorizes the exchanges to recognize these hedges as non-enumerated hedges. Because they are common in the commodity industry, FIA recommends that the Commission adopt these hedges as enumerated hedges. By recognizing common hedging strategies as enumerated hedges, the Commission will significantly decrease the administrative burden for hedgers, exchanges, and Commission Staff by eliminating unnecessary applications for non-enumerated hedge exemptions.

C. The Commission Should Rely on the Expertise of the Exchanges to Administer Non-Enumerated Hedge and Spread Exemptions

FIA supports the proposal to authorize the exchanges to grant non-enumerated hedge and spread exemptions from CFTC and exchange-set limits, including during the last five days of trading. However, the proposed process for the Commission to review exchange non-enumerated hedge and spread exemption determinations continues to create regulatory uncertainty. As proposed, there is no time limit within which the Commission must elect to review an exchange's non-enumerated hedge and spread exemption determinations. This means that a market participant who holds a non-enumerated hedge or spread exemption faces the risk that the Commission might review and overturn an existing exemption for the entire period while the participant holds the exemption.

FIA recommends that the Commission continue its existing practice of approving rules issued by exchanges governing the process for an exchange to review and approve applications for exemptions. Thereafter, the Commission should continue to monitor the exchanges' administration of their rules through the Commission's rule enforcement review process. This framework effectively leverages the expertise of the exchanges to grant hedge exemptions and reserves the authority for the Commission to conduct oversight of the exchange review process. Contrary to the concerns expressed in the preamble, the Commission's delegation of authority to the exchanges is not impermissible because the Commission (1) provides the exchanges with the statutory standard to grant a non-enumerated hedge exemption (*i.e.*, the definition of *bona fide* hedging position in CEA Section 4a) and a spread exemption (*i.e.*, CFTC Rule 150.10); and (2) reserves the ability to conduct a *de novo* review through the rule enforcement review process.[31]

In the alternative, if the Commission intends to conduct an exemption-by-exemption review as the exchanges grant the exemptions, FIA believes that it is important that the Commission's rules provide a finite period of time within which the Commission reviews an exchange exemption determination. For example, the Commission could reserve a 180-day period to review an exchange-granted exemption, after which the exemption is deemed granted by the Commission. The 180-day period provides ample time for the Commission to

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[31] *See* Reproposal at 96815.

conduct a review.[32] The Commission should consider the fact that a 180-day review period is longer than the Commission's review period for the voluntary submission and self-certification of exchange rules.[33]

D. The Commission Should Remove the "Active Trading" Requirement for Exchanges to Grant Non-Enumerated Hedge and Spread Exemptions

FIA supports the clarification that the one year of experience prerequisite to an exchange granting non-enumerated hedge or spread exemptions may be satisfied through institutional or individual staff experience. However, the Commission should eliminate the requirement that an exchange contract (or a contract in the same commodity) be "actively traded" for an exchange to be able to grant non-enumerated hedge or spread exemptions. The active trading requirement creates barriers to entry for new exchanges and for existing exchanges seeking to expand into new markets.[34] Although the Commission expressed concern that an exchange without an actively traded contract "may not have their interests aligned with the CEA's policy objectives for position limits," the one year of exchange experience requirement should adequately ensure an appropriate review in accordance with the CEA.[35] Furthermore, the Commission can utilize its oversight authority to ensure the proper administration of the non-enumerated hedge and spread exemptions.

E. The Pass-Through Swap Exemption Should Promote Liquidity by Allowing More Than The Initial Liquidity Provider to Rely on the Exemption

FIA supports the Commission's adoption of the pass-through swap exemption. As proposed, if a *bona fide* hedging counterparty enters into a swap with a non-*bona fide* hedger, the pass-through swap exemption allows the non-*bona fide* hedging party to treat the swap as a *bona fide* hedge provided that it offsets the risk of the swap with an offsetting derivative. For example, if an airline enters into a swap with a swap dealer to hedge the price of jet fuel, the swap dealer can treat the swap with the airline as a *bona fide* hedge provided that the swap dealer enters into futures or swaps to offset the risk of the swap with the airline. In addition, the swap dealer's offsetting positions also qualify as a *bona fide* hedge.

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32 Similar to FIA's suggested approach for rule enforcement reviews, a 180-day review process would be a proper delegation of Commission authority because the Commission provides the exchanges with reasonably fixed standards to grant an exemption (i.e., CEA Section 4a(c)(2) and CFTC Rule 150.10), and the Commission reserves the 180-day period to conduct a *de novo* review.

33 *See* CFTC Rules 40.5 and 40.6.

34 *See* Proposed Rules 150.9(a)(1)(iii) and 150.10(a)(1)(ii).

35 *See* Reproposal at 96831.

FIA also urges the Commission to expand the pass-through swap exemption to parties beyond the immediate parties to the swap with the *bona fide* hedging counterparty. For example, if the swap dealer chooses to hedge the risk of the swap with the airline by entering into an offsetting swap with another counterparty, the second counterparty should be eligible to rely on the pass-through swap exemption as long as the initial swap dealer represents that it is hedging a pass-through swap. An expansion of eligible counterparties would promote increased market liquidity because more parties will be willing to offset the swap dealer's risk. The added liquidity would benefit the end-user community because swap liquidity providers would be more willing to enter into swaps in less liquid contracts knowing that more counterparties would be available to hedge their risk.

IX. The Proposed Reporting Requirements are Overly Complicated, Burdensome, and Provide the Commission with Limited Benefits

The Reproposal includes a multitude of forms that will require market participants to expend significant capital and labor resources to collect and check the required date, and to prepare and submit the reports. These costly reporting forms do not appear to provide the Commission with meaningfully better data compared to less burdensome alternatives. The Commission should streamline its proposed reporting requirements in order to reduce the extensive burden on market participants and to provide the Commission with the data necessary to operate an effective surveillance program.

A. The Commission Should Eliminate the *Bona Fide* Hedging Forms and Instead Rely on the Exchanges to Collect Cash Market and Other Exposure Information

The Commission's stated purpose for the *bona fide* hedge-related forms is to allow "the Commission to monitor and enforce the speculative position limits that have been established, among other regulatory goals."[36] With this stated purpose in mind, the Commission should utilize the expertise and experience of the exchanges to obtain cash market and other exposure information sufficient to monitor whether a person's cash position or other exposure supports a position above a speculative position limit. As the Commission is aware, the exchanges administer *bona fide* hedge and risk management exemptions via an annual application process. A market participant must provide the exchange with its reasonably expected maximum exposure that justifies an exemption. The exchange then monitors a market participant's positions subject to a limit throughout the year. Thereafter, market participants renew their exemptions annually. This process has worked well over the course of several decades.

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[36] *See* Reproposal at 96799-80. FIA notes that the Commission declined to explain the "other regulatory goals" for the position limit forms. *See* Reproposal at 96780. Absent context or insight into the other regulatory goals, FIA is unable to provide comment on this topic.

FIA recommends that the Commission utilize a similar process if it decides to establish federal position limits. The Commission should leverage the expertise of the exchanges to administer the *bona fide* hedge and risk management filings in order to limit the administrative burden on the Commission. For example, the Commission could establish a hedge filing system whereby a market participant that intends to exceed a federal limit must file a notice (renewed annually) with an exchange detailing its reasonably expected maximum exposure for each calendar month of the year. The exchange would then provide the Commission with the notice filing supporting the participant's exemption.[37] Similar to the current exchange process, if there is a material change to a participant's expected maximum exposure, the participant could supplement the filing during the year, if necessary.

The Commission could use the information provided by the exchange to determine the maximum size of a participant's position that is eligible for an exemption. To the extent that Commission Staff have questions about a participant's exemption-eligible exposure on a particular day, the Commission could utilize its special call authority. This proposed process provides the Commission with data similar to the data required by the plethora of proposed *bona fide* hedging forms. As the Commission is aware, the proposed *bona fide* hedging forms provide the Commission with cash market position data as of the last Friday of the month. Therefore, similar to FIA's proposed process, the Commission would need to issue a special call to determine whether a participant's Referenced Contract position is within a *bona fide* hedge exemption on a particular day. The main difference between FIA's proposed process and the Commission's proposed forms is that FIA's approach would significantly reduce the costs on industry along with the administrative burden on the Commission to collect, collate and analyze the information requested in the proposed forms.

B. If the Commission Retains the *Bona Fide* Hedging Forms, the Commission Should Streamline the Forms to Reduce Ambiguity

The Reproposal includes a total of four *bona fide* hedging related forms: 204, 304, 604 and 704. Each Form has a different timeframe associated with filing, requests differing data, and in certain instances, *bona fide* hedgers will need to file more than one form. To the extent the Commission declines to adopt FIA's suggested approach of filing annual position information with the exchanges, the CFTC should consolidate the Forms and make the following improvements:

- *Remove the Form 704 and Associated Application Requirements*. Market participants that rely on a hedge exemption would be required to file the monthly Form 204 and include, among other things, a statement of anticipatory

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[37] For example, if the limit is 100, and a participant holds 90 long OTC positions and 50 long positions on a DCM, the participant would need to submit a notice to the DCM.

hedges. Notwithstanding the reporting of anticipatory hedges on Form 204, a market participant also would be required to file a Form 704 at least ten days prior to exceeding a speculative position limit (updated annually) in order to engage in anticipatory hedges.[38] Because anticipatory hedges would be reported on the monthly Form 204, the Commission should eliminate the initial Form 704 and the annual update. The removal of the Form 704 necessarily would entail withdrawing proposed Rule 150.7, which details the requirement to file the Form 704 at least 10 days in advance of exceeding a limit. The monthly Form 204 will provide the Commission with sufficient information to monitor a market participant's anticipatory hedges to ensure that a market participant is not evading position limits.[39]

- *Move All Pass-Through Swap Reporting to Form 204 and Eliminate Daily Reporting*. Market participants who rely on a hedge exemption for pass-through swaps will be required to file the monthly Form 204 when the swap being hedged is a Referenced Contract.[40] However, if the underlying swap being hedged is not a Referenced Contract, the participant instead will be required to file the monthly Form 604.[41] Furthermore, if the participant hedges the swap with a physical delivery Referenced Contract held during the spot month, the participant will be required to file the daily version of the Form 604. The use of multiple forms with disparate frequency for a single exemption is unnecessarily burdensome. Instead, the Commission should move all reporting for pass-through swaps to the Form 204. Furthermore, as FIA has recommended in the past, the Commission should eliminate daily reporting associated with the pass-through swap exemption because monthly reporting provides the CFTC with sufficient information to ensure compliance with position limits.

Finally, FIA supports the Commission's clarification that filers may identify multiple Referenced Contracts used to hedge a cash commodity position in the same line item on Form 204. It would be a time consuming process for market participants to list each Referenced

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[38] *See* Proposed Rule 150.7.

[39] *See* Reproposal at 96811. FIA notes that if the Commission retains the Form 704, the Form should accommodate market participants who do not have three years of prior anticipatory exposure. Although the instructions allow a market participant to submit less than the prior three years of anticipatory exposure, column 6 of proposed Form 704 requires the submission of the prior three years of exposure.

[40] For example, a dealer enters into a crude oil swap with a *bona fide* hedger, and the dealer hedges the heating oil swap with the NYMEX crude oil futures contract.

[41] For example, a dealer enters into a jet fuel swap with a *bona fide* hedger, and the dealer hedges the jet fuel swap with the NYMEX ULSD futures contract.

Contract on a separate line, and identify the cash position associated with each Referenced Contract.

C. The Commission Should Eliminate the Daily Reporting Requirements for the Form 504

As FIA has commented in the past, it is not technologically practicable to report cash market exposure on a daily basis.[42] For certain cash markets, FIA expects that market participants could only estimate cash market exposure on a daily basis. For example, in the crude oil markets, nominations to move crude oil from one terminal to another occurs one month in advance. However, during the month when delivery occurs, the seller will not know the exact quantity delivered on each day until the month after delivery.[43] For refined products delivered via a pipeline, a market participant will not be able to report accurately its exact cash position on a daily basis because the pipeline does not confirm the quantity delivered until approximately fifteen days after the delivery cycle. Similar cash position measurement issues arise in other cash commodity markets.

The daily reporting for Form 504 would impose significant costs on industry. Market participants would need to develop automated systems to estimate quantities, in some cases, across multiple regions of the world that account for delivery discrepancies, shrinkage, loss, decline in quality, and degradation, among other factors. In addition, market participants would need to adjust their existing accounting systems, which typically are updated monthly, to a daily system for which there is no business purpose. Thereafter, market participants would need to process their estimates into a format consistent with the Commission's one-size-fits-all form. Finally, for global enterprises, the daily filing requirement does not provide sufficient time to collect and verify data from multiple systems that may cover all time zones.

All of these costs do not appear to provide the Commission with a corresponding benefit beyond less costly alternatives. According to the preamble, the Commission is requesting the information on the Form 504 "to detect and deter manipulative activities in the underlying commodity that might be used to benefit a derivatives position (or vice-versa)."[44] The Commission could conduct similar surveillance through the use of its special call authority on an as-needed basis.

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42 *See* FIA letter to CFTC, pp. 18-19, (July 13, 2016).

43 *See id.*

44 *See* Reproposal at 96807.

X. The Commission Should Conform the Rule Text for Spread Exemptions to the Preamble

FIA recommends that the Commission amend the text of proposed CFTC Rule 150.10 to conform the scope of potential spread exemptions to the language in the preamble. Proposed CFTC Rule 150.10(a)(2) provides a list of "[s]preads that a [DCM] or [SEF] may approve under this section." In response to comments, the preamble confirms that "the list of spreads in 150.10(a)(2) is not an exhaustive list and that exchanges may grant other spread exemptions so long as they meet the requirements in 150.10(a)(1), (3), and (4)(vi)." [45] To conform the rule text and the preamble, FIA recommends the Commission add the language below to 150.10(a)(ii). In addition, because the non-exhaustive list of spread exemptions is meant to provide common examples of spreads, the Commission should add location spreads to the list because it is a common spread position.

> 150.10(a)(2): ***Examples of*** spreads that a designed contract market or swap execution facility may approve under this section include***, but are not limited to***:
>
> (i) Calendar spreads;
>
> (ii) Quality differential spreads;
>
> (iii) Processing spreads;
>
> (iv) Product or by-product differential spreads***; and***
>
> ***(v) Location spreads***

XI. The Commission Should Provide the Exchanges with Discretion for Limits, if any, for Non-Referenced Contracts

In the Reproposal, the Commission cited to the track record of exchange-administered speculative position limits as a reason to delegate non-enumerated and spread exemptions to the exchanges.[46] Given the exchanges' proven track record, the Commission should not attempt to fix a problem that does not currently exist. FIA recommends that the Commission continue to provide the exchanges with discretion to set hard limits or accountability levels, as the exchange deems necessary, for contracts that are not subject to federal limits. This approach is consistent with DCM Core Principle 5 of the CEA, which provides the exchange with

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[45] *See* Reproposal at 96833.

[46] *See* Reproposal at 96813-14.

discretion to adopt position limitations or accountability levels "as is necessary and appropriate."[47]

XII. The Commission Significantly Underestimates the Costs Associated with the Reproposal

To the extent that the Commission moves forward with final position limits rules, FIA's recommendations above are designed to reduce the burden on market participants and, at the same time, retain the surveillance benefits for the Commission. As part of the Commission's consideration of the comments to the Reproposal, FIA urges the Commission to reevaluate its cost-benefit analysis. FIA is concerned that the Commission did not estimate certain costs and significantly underestimated other costs. The understated and incomplete estimates prevent the Commission from carefully weighing the costs and benefits of the Reproposal as required by CEA Section 15(a).

One of the key aspects missing from the Commission's cost-benefit analysis is the expected cost to monitor positions subject to a position limit. Although the Commission expects "minimal compliance costs" for market participants with positions below the proposed limits, this expectation ignores the extensive costs necessary for participants to track their positions.[48] The tracking process includes identifying Referenced Contracts subject to a limit, developing new systems to pull data from existing trade capture systems, and the development of processes and controls for when positions exceed a certain pre-designed threshold. In short, the rules not only impose costs on market participants above a limit, but also impose extensive costs for market participants to ensure that they are below the limit. FIA conducted an informal survey of its members and the majority of respondents believe the cost to develop and maintain a position monitoring program is at least $1 million per year, and some firms believe the cost may exceed $5 million per year. Spread across industry these costs are very substantial. Accordingly, the Commission should reconsider the various aspects of Reproposal to determine whether less costly alternatives are available.

An additional aspect missing from the Commission's cost-benefit analysis is the cost for market participants to reengineer how they evaluate risk to match the Commission's one-size-fits-all definition of *bona fide* hedging. The proposed requirement to hedge on an enterprise basis, the restriction to gross hedging, and the requirement to hedge all cash positions as opposed to portions of a cash portfolio each take flexibility out of the hands of professional risk

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[47] *See* CEA Section 5(d)(5).

[48] *See* Reproposal at 96843 ("As shown in the impact analysis, the Commission seeks to reduce market participants' compliance costs by setting the federal position limits at a level sufficiently high to only affect market participants with very large open interest. Thus, the Commission expects minimal compliance costs for those with positions below these high levels.").

managers. Furthermore, it is unclear how all of the time and effort necessary to reevaluate risk within the Commission's unnecessarily narrow parameters actually prevents excessive speculation.

As discussed above, FIA also believes that the proposed position limit forms impose an extensive burden on industry when the Commission could obtain similar results through less costly alternatives. FIA believes that the Commission's cost estimates for the proposed forms significantly underestimate the actual likely costs. For example, the Commission proposes that the annual cost to complete the Form 204 is $4,392 per year, but a majority of respondents to an informal FIA survey indicated the cost to be greater than $50,000 per entity. In other words, the Commission's estimate understates the likely cost to prepare a single proposed form by more than 1,000 percent. Given that the projected cost to prepare each of the required forms likely will be significantly higher than estimated by the Commission, it should reevaluate the costs and benefits associated with all of the proposed forms.

XIII. Conclusion

FIA remains concerned that key aspects to the Commission's position limits proposal will impose unnecessary burdens, restrict the ability to manage risk, and adversely impact liquidity for *bona fide* hedgers and other market participants. FIA urges the Commission to withdraw its current rulemaking and undertake an empirical analysis to determine when speculative activity becomes excessive. In the alternative, FIA requests that the Commission adopt FIA's recommended revisions to the Reproposal before issuing final position limit rules.

Please contact Allison Lurton, Senior Vice President and General Counsel, at 202-466-5460, if you have any questions about FIA's comments or recommendations.

Respectfully submitted,

Walt L. Lukken

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