March 28, 2011

Mr. David A. Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington DC 20581

Re: Notice of Proposed Rulemaking — Position Limits for Derivatives

Dear Mr. Stawick:

The Asset Management Group (the "**AMG**") of the Securities Industry and Financial Markets Association ("**SIFMA**") appreciates the opportunity to provide the Commodity Futures Trading Commission (the "**CFTC**" or the "**Commission**") with our comments and recommendations set forth below regarding the proposed rules (the "**Proposed Rules**") published in the Commission's Notice of Proposed Rulemaking (the **"NPR"**)[1] relating to position limits under Section 737 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Dodd-Frank Act**").

The AMG's members represent U.S. asset management firms whose combined assets under management exceed $20 trillion. The clients of AMG member firms include, among others, registered investment companies, ERISA plans and state and local government pension funds, many of whom invest in commodity futures, options and swaps as part of their respective investment strategies.

As previously discussed in the AMG's Pre-Rulemaking Position Limits Comments letter dated November 23, 2010 (the "**AMG Prior Letter**"),[2] the AMG supports the goals set forth in the Dodd-Frank Act for setting appropriate position limits, namely to prevent market manipulation, ensure sufficient market liquidity for bona fide hedgers, and deter disruption to price discovery, including preventing price discovery from moving to foreign boards of trade ("**FBOTs**"). However, position limits also present the danger of undermining the stated purposes, particularly if set prematurely or at too restrictive levels and without proper exclusions. Indeed, Congress recognized that position limits, if set inappropriately, may adversely impact market liquidity, disrupt the price discovery function of the U.S. commodity markets and cause migration of trading activity to FBOTs.

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[1] Position Limits for Derivatives, 76 Fed. Reg. 17, 4752 (Jan. 26, 2011) ("**NPR**"), available at http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-1154a.pdf.

[2] *See* AMG Prior Letter (filed Nov. 24, 2010), available at http://www.cftc.gov/ucm/groups/public/@swaps/documents/dfsubmission/dfsubmission26_112410-sifma.pdf.

With this background and as discussed in further detail below, the AMG respectfully requests that the Commission consider the following recommendations:

- The AMG urges the CFTC to delay adoption of position limits until an "appropriateness" determination can be made. In making that determination, the Commission should consider the impact of any proposed limits in causing price discovery to shift to FBOTs.

- If the Commission should choose to proceed with the adoption of limits, it should limit the scope of Phase One and not adopt proposed Phase Two at this time, given the absence of sufficient market data and the lack of evidence that non-spot-month positions have caused excessive price volatility.

- With respect to any position limits adopted by the Commission, the following changes should be made:

    - The AMG recommends that the Commission permit disaggregation of separately owned funds and accounts. At a minimum, if separately owned funds and accounts are required to be aggregated, the AMG emphatically requests that the Commission retain the independent account controller safe harbor for financial as well as non-financial entities.

    - The AMG recommends that the Commission consider safe harbor or other exemptive treatment for registered investment companies, ERISA and similar accounts, and funds and accounts that are diversified and unleveraged and take passive, long-only positions.

    - The AMG recommends that grandfathering treatment be extended to rolled futures and swaps positions that exist as of the effective date of any position limit rule.

    - The AMG recommends that the bona fide hedging exemption include economic risk mitigation, as a narrow interpretation runs counter to the mandate that the Commission limit only speculative positions.

    - A "position points" regime should not be implemented without a formal rulemaking process.

I. The AMG encourages the CFTC to delay adoption of position limits until an "appropriateness" determination can be made.

The AMG respectfully disagrees with the Commission's assertion in the Proposed Rules that it has been granted authority by Congress to impose position limits prophylactically.[3] As discussed in the AMG Prior Letter, the AMG strongly believes that

[3] Commissioner Dunn appears to agree with this view. *See* Commissioner Michael V. Dunn, Opening Statement, Public Meeting on Proposed Rules Under Dodd-Frank Act (Jan. 13, 2011) ("**Dunn**
(…continued)

the Commission must first make an appropriateness determination before any limits are established.[4] The AMG believes that in order for the Commission to set position limits "as appropriate" to the enumerated goals set forth in the Dodd-Frank Act, factual support must demonstrate the necessity, consistent with these enumerated objectives, for position limits to be established, and any position limits so established should be appropriately tailored to both the type of underlying commodity and the class of traders being targeted.[5] In addition, the Commission must strive to ensure that any limits imposed will not cause commodity price discovery to shift to FBOTs.[6] However, as discussed further below, the Proposed Rules do not address this concern or provide any factual support or data evidencing that the proposed limits are either necessary or appropriate.[7] Until such an appropriateness determination can be made, the AMG requests the CFTC to postpone the adoption of any position limits.

A. There is insufficient evidence that speculation is generally affecting the commodities markets.

The Commission states in the Proposed Rules release that its statutory authority for adopting the Proposed Rules originates from its congressional mandate to address unreasonable price fluctuations attributable to excessive speculation.[8] Although some commentators have opined that speculators have distorted the price of commodities in the past, the AMG is not aware of any empirical, peer-reviewed academic study that adequately proves this out. In contrast, numerous studies have found no substantial evidence of excessive speculation, including the following findings:

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January 13 Statement"), available at http://www.cftc.gov/PressRoom/SpeechesTestimony/dunnstatement011311.html.

[4] Specifically, the Commission is directed to set position limits "*as appropriate* . . . [and] to the maximum extent practicable, in its discretion, to (i) diminish, eliminate or prevent excessive speculation . . .; (ii) deter and prevent market manipulation, squeezes, and corners; (iii) ensure sufficient market liquidity for bona fide hedgers; and (iv) ensure that the price discovery function of the underlying market is not disrupted (emphasis added). Section 4a(a)(3)(B) of the CEA.

[5] As Commissioner Sommers has noted, "Section 4a(a)(1) of the Commodity Exchange Act, Congress specifically authorized the Commission to consider different limits on different groups or classes of traders. This language was added in Section 737 of Dodd-Frank. The proposal before us today does not analyze, or in any way consider, whether different limits are appropriate for different groups or classes of traders." Commissioner Jill E. Sommers, Opening Statement, Public Meeting on Proposed Rules Under Dodd-Frank Act (Jan. 13, 2011) ("**Sommers January 13 Statement**"), available at http://www.cftc.gov/PressRoom/SpeechesTestimony/sommersstatement011311.html.

[6] Section 4a(a)(2)(C) of the CEA.

[7] *See* Dunn January 13 Statement, *supra* note 3 ("Price volatility exists in markets that have position limits and in markets that do not have position limits."); Commissioner Scott D. O'Malia, Statement, Prior to Notice of Proposed Rulemaking – Position Limits for Derivatives (Jan. 13, 2011) ("**O'Malia January 13 Statement**"), available at http://www.cftc.gov/pressroom/speechestestimony/omaliastatement011311.html ("I do not believe that the absence of position limits has had any impact on prices in the past, and I do not believe that setting them now will be effective in preventing a barrel of oil from going over $100/barrel."); Sommers January 13 Statement, *supra* note 5.

[8] NPR, *supra* note 1, 76 Fed. Reg. at 4753-54.

- No clear evidence of a causal relationship between increased financial market participation and commodity prices;[9]

- No clear evidence that speculation has affected underlying supply and demand for agricultural products;[10]

- No clear evidence as to whether derivatives have a long-term impact on commodity price levels;[11] and

- That fundamental supply and demand factors in the commodity markets, rather than participation by non-commercial market participants, were more likely to have caused price volatility in commodities in 2005-2008.[12]

The AMG believes that Commissioner Michael V. Dunn summed it up best with the following remarks made at the Commission's January 13, 2011 open meeting in which the Proposed Rules were approved: "To date, CFTC staff has been unable to find any reliable economic analysis to support either the conclusion that excessive speculation is affecting the markets we regulate, or that position limits will prevent excessive speculation. . . .With such a lack of concrete economic evidence, my fear is that, at best, position limits are a cure for a disease that does not exist or at worst, a placebo for one that does." [13]

B. Insufficient data currently exists to appropriately establish and enforce limits.

As discussed in the AMG Prior Letter, adequate data on the swaps market is not yet available to accurately establish and enforce position limits and will not be for some time. The AMG agrees with the views expressed by Commissioner Jill E. Sommers that sufficient and reliable swaps market data must be collected before the Commission can reasonably analyze the appropriateness of any position limit formulas to be established.[14]

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[9] Global Financial Stability Report: Financial Stress and Deleveraging, Macrofinancial Implications and Policy – Annex 1.2, International Monetary Fund (October 2008).

[10] Global Agricultural Supply and Demand: Factors Contributing to the Recent Increase in Food Commodity Prices, USDA (May 2008). *See also* Causes of High Food Prices, Asian Development Bank (October 2008).

[11] OECD-FAO Agricultural Outlook 2008-2017 (2008).

[12] *See, e.g.,* Dwight R. Sanders and Scott H. Irwin, *A speculative bubble in commodity futures? Cross-sectional evidence*, Agricultural Economics 41, 25-32 (2010); October 2008 IMF World Economic Outlook. As another example, preliminary analysis of the CFTC Inter-Agency Task Force on Commodity Markets in July 2008 suggested that fundamental supply and demand factors are the underlying cause of oil price volatility rather than speculators. *See* Interim Report on Crude Oil, Interagency Task Force on Commodity Markets (July 2008), available at http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/itfinterimreportoncrudeoil0708.pdf.

[13] *See* Dunn January 13 Statement, *supra* note 3.

[14] *See* Sommers January 13 Statement, *supra* note 5 ("[T]he Commission "should conduct a complete analysis of the swap market data before [it] determine[s] the appropriate formula to propose.")

Until such time, the AMG believes that the imposition of limits, including any Phase One spot-month position limits, is premature and presents the danger of unintended consequences that could, in fact, undermine the stated purposes for position limits articulated in the Dodd-Frank Act. Furthermore, the current lack of adequate infrastructure for any position limits on swaps to be reasonably enforced is a concern that should be addressed before any limits become effective.[15]

C. In establishing limits, the Commission must consider the impact of any proposed limits in causing price discovery to shift to FBOTs.

Section 4a(a)(2)(C) of the Commodity Exchange Act (the **"CEA"**), as amended by Section 737 of the Dodd-Frank Act, requires the CFTC to "strive to ensure that trading on foreign boards of trade in the same commodity will be subject to comparable limits and that any limits to be imposed by the Commission will not cause price discovery in the commodity to shift to trading on the foreign boards of trade."[16] As Commissioner Sommers has noted, the Proposed Rules fail to even consider or mention this goal.[17] It appears that foreign regulators either are not currently acting on position limits for commodity derivatives or are significantly behind the Commission's proposed timeline.[18]

The AMG believes that unless foreign jurisdictions are also coordinated and ready to apply comparable position limits (if indeed any such limits are determined to be appropriate) on the same timeline, it would seem that it would run counter to this mandate for the Commission to impose position limits at this time.[19] We share the concerns expressed by Representative Scott Garrett, Chairman of the Subcommittee on Capital Markets and Government Sponsored Enterprises, that in order to prevent

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[15] As Commissioner Sommers expressed, "it is bad policy to propose regulations that the [Commission] does not have the capacity to enforce." *Id.* The AMG agrees with the views of Commissioners Dunn and Sommers (reiterated in sentiments expressed by the Senate Committee on Banking, Housing and Urban Affairs) that more rigorous economic analysis and data, and additional time for adoption of relevant rules, is needed before any limits are imposed. *See* Dunn January 13 Statement, *supra* note 3; Letter to the Commission, the Securities Exchange Commission, the Federal Reserve, the FDIC and Office of the Comptroller of the Currency, United States Senate Committee on Banking, Housing and Urban Affairs (Feb. 15, 2011).

[16] Section 4a(a)(2)(C) of the CEA.

[17] Sommers January 13 Statement, *supra* note 5.

[18] For example, in response to questions posed by Commissioner Dunn about international efforts at the Commission's open meeting on December 16, 2010, Jacqueline Mesa, the CFTC's Head of the Office of International Affairs, stated that the European Commission was not expected to issue an initial proposal regarding the harmonization of position limits across EU authorities until May 2011,at the earliest, and would not likely act upon such a proposal for at least four to six months later. Transcript of the Open Meeting on the Eighth Series of Proposed Rulemakings Under the Dodd-Frank Act (Dec. 16, 2010), available at http://www.cftc.gov/ucm/groups/public/@swaps/documents/dfsubmission/dfsubmission13_121610-transcri.pdf.

[19] *See* Dunn January 13 Statement, *supra* note 3 ("If we determine that position limits are appropriate to diminish, eliminate or prevent excessive speculation, I think we must then work with our sister regulators around the globe to ensure that limits set here in US markets, are not simply evaded by trading in other venues around the world.")

regulatory arbitrage, "real, concrete assurances" are needed in this regard.[20] Without more careful study and policy coordination with foreign jurisdictions, the imposition of position limits in the United States would likely result in moving commodities trading overseas, undermining the directive to the Commission in the Dodd-Frank Act.

D. Position limits established inappropriately may result in unintended adverse consequences that affect all participants in the commodities markets.

The Commission is directed to set position limits consistent with the objectives of ensuring sufficient market liquidity for bona fide hedgers and that the price discovery function of the underlying market is not disrupted.[21] As noted in the AMG Prior Letter, position limits imposed inappropriately, without the benefit of fully analyzing sufficient data concerning open interests in each market and the impact of limits on liquidity, bona fide hedging and prices could actually run counter to these enumerated purposes, potentially resulting in unintended adverse consequences to the commodities markets affecting not only holders of substantial positions, but all market participants generally. Set inappropriately either as to timing of implementation or level, position limits could negatively affect the ability of bona fide hedgers, including commodity producers and end-users, to hedge and reduce risk; potentially increase volatility in commodity prices; and impair liquidity and price discovery of the U.S. commodity markets. In turn, these effects could inhibit legitimate business activities, such as new commodity production and exploration projects, causing supply distortions and thereby potentially leading to higher commodity (or other) prices. Commodity-related companies and end-users could also elect to undertake normal activities without hedging their risks due to limited market liquidity, thereby creating more risk in the marketplace. The AMG strongly agrees with Congressmen Spencer Bachus and Frank Lucas, Ranking Members of the House Committees on Financial Services and Agriculture, respectively, that "[o]verly-prescriptive limits would drain existing liquidity from the capital markets, impair price discovery for commercial producers and their counterparties, and cause unnecessary harm to the futures markets and small investors."[22]

The AMG therefore questions the appropriateness of position limits at all in light of the enumerated purposes of ensuring market liquidity and price discovery set forth under Section 737 of the Dodd-Frank Act.

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[20] Representative Scott Garrett, Letter to the Chairman Gary Gensler (Mar. 3, 2011), available at http://dealbook.nytimes.com/2011/03/08/republicans-seek-to-slow-c-f-t-c-rule-writing/

[21] Section 4a(a)(3)(B) of the CEA.

[22] *See* Letter dated December 16, 2010 from Congressman Spencer Bachus and Congressman Frank Lucas to the Honorable Timothy Geithner, the Honorable Gary Gensler, et al. (the "**Bachus/Lucas Letter**"), available at http://online.wsj.com/public/resources/documents/bachus.pdf.

II. *Should the Commission choose to proceed with adoption of limits, the AMG would recommend solely adopting a more limited version of Phase One of the proposed regime.*

A. *Phase One of the Proposed Rules should be more limited.*

If the Commission proceeds with Phase One of its position limits proposal, the AMG recommends that limits on cash-settled contracts should be forgone at this time. A limit based on the estimated spot-month deliverable supply of the referenced commodity on cash-settled contracts, as opposed to a limit based on open interest, seems arbitrary as the number of cash-settled contracts does not have a direct correlation to the spot-month deliverable supply of the underlying commodity. In addition, the AMG does not believe that it is appropriate for the Commission to have the discretion to determine estimated deliverable supply if it does not agree with figures provided by designated contract markets; it is also unclear what criteria the Commission would apply in making this determination. Market participants should also be permitted to net their cash-settled and physically-settled positions in a spot month in order to accurately reflect their aggregate spot-month positions.

Importantly, if too restrictive limits are imposed on cash-settled contracts, market participants could migrate to the physical commodity markets themselves, which are not subject to the Commission's jurisdiction. This migration could not only result in liquidity providers to hedgers disappearing from the cash-settled market, but could also result in pricing pressure being applied to the market for underlying physical commodities, thereby counteracting the intentions of position limits.[23]

B. *Phase Two of the Proposed Rules should not be adopted.*

The AMG is not aware of evidence that non-spot-month positions of any size have contributed to excessive price volatility or otherwise pose a threat to markets, or of any reasoning offered in support of such a conclusion. In addition, the AMG believes that the opportunity for excessive speculation or market manipulation in non-spot months is either non-existent or dramatically lower than in the spot month. Accordingly, we respectfully suggest that it is premature at this time to consider imposing position limits outside the spot month.

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[23] For example, in the face of position limits, a large institutional investor that elects to invest in cash-settled contracts for oil due to efficiency and convenience could decide to limit its purchase of oil contracts and purchase oil directly (assuming it had the capacity to store it) or indirectly through an exchange-traded fund (ETF) that holds nothing but physical oil. Purchasing oil, or an ETF that purchases oil, would have a more direct effect on the price of oil than investing in cash-settled derivative contracts. The investor would offer less liquidity to hedgers in the cash-settled contract market and would have a greater impact on the price of oil as a result of its actions in response to the cash-settled contract limits. *See also* Craig Pirrong, The Problems With Physical Commodity ETFs, Seeking Alpha (Oct. 27, 2010), available at http://seekinga~pha.c~m/artic~e/232559-~ae-pr~b~ems-wi~a-phvsica~-c~mm~dit'/-etfs ("There is a perverse irony here. The whole rationale (supposedly) for position limits is that speculation somehow distorts physical markets. There is precious little evidence . . . that this is a real problem. But by driving those that want exposure to metals prices . . . , regulations are making it more likely that speculation will distort prices and the physical markets.")

Further, as discussed above, even if there were evidence that non-spot-month limits were necessary to prevent excessive speculation, there is not yet adequate data on the size of the market for economically equivalent swaps relating to the referenced commodities, or on the concentration, trading and other characteristics of that market. The AMG submits that without such data, and careful economic analysis of its implications where the policies underlying position limits are concerned, any formula for determining limits is necessarily arbitrary and poses a greater risk of negative, unintended consequences.

The AMG respectfully submits that the appropriateness of the Commission's proposed formula for all months combined and single (non-spot) month limits is unsupported by any analysis or data. For a large market of, for example, 500,000 contracts of average open interest for all months combined,[24] the "10 percent, 2.5 percent" limit would end up working out to under 3 percent of average open interest. Without further support or examples of cases in the past where positions of this size have caused harmful instability, the AMG believes that a limit of this size would be an inappropriate result. If Phase Two position limits are adopted at this time, the AMG recommends that they be set sufficiently high until appropriate market data is known. Levels higher than ten percent of all contracts may be appropriate until sufficient information is available; as Commissioner Chilton has acknowledged, it is most prudent "to err on the high side at first—precisely to avoid any negative consequences—and re-calibrate as we move forward and know more about the markets."[25] Furthermore, once adequate data is available on open interest, it may make sense to adopt different limits for different commodities to properly reflect the relative sizes of the relevant markets. At this stage, however, the AMG recommends forgoing the proposed Phase Two limits.

III. Funds and accounts managed by an investment adviser should be disaggregated in applying any limits adopted by the Commission.

A. Positions held in separately managed funds and accounts do not pose the risks that the Commission has associated with concentrated positions and should not be aggregated.

The Commission states in the NPR that the economic justification for limits is that large concentrated positions "can potentially facilitate price distortions given that the capacity of any market to absorb the establishment and liquidation of large positions in an orderly manner is related to the size of such positions relative to the market."[26] The Commission adds that concentration of positions can also "create the unwarranted

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[24] The February 2011 month-end open interest for the referenced CBOT Wheat, Corn and Soybeans futures contracts, for example, were all near or over 500,000. *See* CME Group CBOT Exchange Open Interest Report, available at http://www.cmegroup.com/wrappedpages/web_monthly_report/Web_OI_Report_CBOT.pdf. When swap open interest is added, totals will obviously be considerably higher, and limits under the proposed formula lower as a percentage matter.

[25] *See, e.g.,* Interconnectedness: Keynote Address of Commissioner Bart Chilton to the 13th Annual Structured Trade and Finance in the Americas Conference (Mar. 15, 2011), available at http://cftc.gov/PressRoom/SpeechesTestimony/opachilton-40.html.

[26] NPR, *supra* note 1, 76 Fed. Reg. at 4755.

appearance of appreciable liquidity."[27] The assumption underlying both concerns appears to be that the holder of a large concentrated position is likely to disrupt prices and liquidity in the market if it establishes or disposes of most of its position all at once or is forced to liquidate.

This assumption does not hold true when the "holder" of a position is in fact a multitude of accounts and funds with disparate owners and investment considerations, as discussed in the AMG Prior Letter.[28] Even where accounts and funds have a common investment adviser, each is a distinct client, and the adviser as a fiduciary is required to base purchase and sale decisions *solely* on the interests of that client, based on its unique circumstances. The AMG believes that the statutory fiduciary obligations[29] of investment advisers sufficiently mitigate the risk of coordinated action. An adviser's decision to increase or decrease a position held by a given client in a given commodity contract necessarily depends on a number factors specific to that client, including: the client's investment objectives and guidelines; the nature of the client and its investors or beneficiaries; its instructions to the adviser; its benchmarks and asset mix; its hedging needs; its choice of collateral; and the extent of leverage it utilizes, if any, among other factors. Similarly, if one fund or account managed by a particular adviser is required to liquidate, it does not follow that other funds or accounts managed by the same adviser would unwind their positions at the same time. Furthermore, in order to address conflict of interest issues that may arise in serving as fiduciaries to multiple clients—for example, to achieve best execution and allocate investment opportunities in accordance with each client's best interests—advisers often have procedures in place that do not permit the sharing of information, let alone the coordination of trading activity, among separate funds and accounts. Any concern that separate funds and accounts would necessarily act in concert when establishing or disposing of positions or exiting the market seems unfounded.

It is therefore incorrect to assume that disparate funds and accounts of a given adviser will trade in tandem in a manner that results in major market impacts, and that aggregation among separately owned funds and accounts is therefore required to protect markets from disruption. Senator Lincoln recognized this when she stated in a July 16, 2010 Senate Colloquy that she "would encourage the CFTC to consider whether it is appropriate to aggregate positions of entities advised by the same advisor where such entities have different and systematically determined investment objectives." Such aggregation is particularly inappropriate in the case of funds that are tracked to an index, such as the Dow Jones-UBS commodity index, and mechanically increase or decrease positions based on entry and withdrawal by investors. Purchase and sale decisions for these types of funds are in effect made more by large numbers of individuals acting

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[27] *Id.*

[28] *See* AMG Prior Letter, *supra* note 2, at 9-10.

[29] *See* Section 206 of the Investment Advisers Act of 1940; SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 192-93 (1963). Advisers to registered investment companies and ERISA and similar plans are subject to further statutory fiduciary provisions; *see, e.g.,* Section 36 of the Investment Company Act of 1940 (the "**Investment Company Act**"); Section 404(a)(1)(B) of the Employee Retirement Income Security Act ("**ERISA**") ("a fiduciary shall discharge his duties with respect to a plan *solely* in the interest of the participants and beneficiaries and . . . *for the exclusive purpose* of providing benefits to participants and their beneficiaries"(emphasis added)).

independently than by the adviser exercising investment discretion, let alone at a coordinated level across all funds and accounts of the adviser.

B. If the Commission does require aggregation among separately managed funds and accounts, it should preserve the exemption for separately controlled accounts.

As stated above, the AMG believes that aggregation across separately owned funds and accounts is overly expansive, but thinks it is even more unjustified in cases where the separate funds and accounts have independent controllers. The Commission's proposal to require aggregation *even* where separately owned accounts have independent controllers would represent a major and unwarranted departure from long-standing and effective practices. The AMG and many other members of the public commented in advance of the NPR[30] that elimination of the safe harbor under Reg. 150.3(a)(4)(i) (the **"Independent Account Controller Safe Harbor"**) would have considerable negative consequences to market participants. The Commission recognizes these public comments in the NPR and proposes to "address the concern of not having an independent account controller exemption by establishing the owned non-financial entity exemption."[31] The AMG strongly believes that an exemption that relates only to non-financial entities is insufficient and requests that the Commission reconsider this aspect of its proposal.

Elimination of the Independent Account Controller Safe Harbor for financial entities would be costly and damaging to asset managers and their clients. Some AMG firms are members of large and diverse multi-national financial services groups that are affiliated through a common international parent or major shareholder. Affiliates of a single U.S. asset management firm may include, for example, insurance companies, banks, broker-dealers and other asset management firms based and regulated in multiple countries. The Commission's proposed treatment of each of these entities, *and* each of their distinct clients, as a single combined trader, would be expected to have extensive consequences. Some financial services firms could expect to incur considerable expense to gather and monitor swaps positions across companies, countries, funds and accounts that currently operate independently. The cost would be likely to be borne in significant part by advisers' clients—by way of increased expenses, but also by way of constrained investment options, as funds and accounts might be unable to benefit from the strategies that best suit their needs where the global combined positions of all entities that are required to be aggregated are cumulatively at or near the applicable limit.

Elimination of the Independent Account Controller Safe Harbor would be costly and damaging to market participants generally, and to the goals of the Dodd-Frank Act. Although the most direct effects of the proposed elimination of the Independent Account Controller Safe Harbor would be borne by financial entities and their clients, as described above, the AMG anticipates that negative consequences could be much more widespread. Advisers may reduce legitimate trading activity in commodity derivatives, both because of the proposed limits themselves and because of the difficulty and expense of implementing reliable monitoring and compliance procedures for aggregation. This, in

[30] *See* NPR, *supra* note 1, 76 Fed. Reg. at 4756.

[31] *Id.*

turn, could have negative consequences that would be borne market wide;[32] liquidity would be impaired, with resulting higher derivative prices for all participants, and potentially, in direct contravention of the Commission's goals, increased vulnerability to sudden price movements. A less-liquid market where many participants are constrained by limits from accommodating sudden increases in demand or supply is likely to experience more extreme price volatility.

Elimination of the Independent Account Controller Safe Harbor could impair the integrity of information barriers that serve as important safeguards within financial institutions. In order to monitor their aggregated positions, disparate units and accounts that do not currently share information would be required to share and coordinate trading decisions on a real-time basis. The aggregation requirement could therefore have the counter-productive effect of increasing the very risks of concerted action (deliberate or inadvertent) that, the Commission has said, underlie its proposal to eliminate the Independent Account Controller Safe Harbor for financial entities.[33] In many cases, units and accounts not only do not, but are not permitted to, share information or decision-making, because of institutional barriers in place to address other regulatory, contractual or fiduciary concerns or requirements, as discussed above. Requiring financial entities to monitor positions across managed funds or accounts where such information barriers exist would likely cause advisers to breach these barriers, in contravention of internal firm policies and, in many cases, other legal obligations.

In addition, multiple advisers or sub-advisers to a given fund or account often maintain barriers designed to prevent the flow of information from one institution to another. Where such barriers exist, advisers are not required to aggregate the positions of the funds and accounts managed by other advisers for other purposes, such as Sections 13 and 16 of the Securities Exchange Act. The Proposed Rules' attribution of all positions of such a fund to its main adviser would require multiple advisory firms to share and coordinate information on an intra-day basis and would challenge the information barriers that the firms have put in place for regulatory or other valid business purposes.

The Commission has not offered a convincing justification for discarding an effective and widely recognized approach. The main rationale offered for eliminating the Independent Account Controller Safe Harbor for financial firms is that the safe harbor "may be incompatible with the proposed Federal position limit framework and used to circumvent its requirements."[34] The Commission appears to expect that firms may violate their procedures in order to illegally circumvent limits, and that in the case of financial entities the risk of deliberate circumvention is significant enough to justify discarding long-standing barrier procedures and dramatically expanding the scope of aggregation.

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[32] *See, e.g.,* Letter dated Jan. 24, 2011 from Prof. Craig Pirrong, paragraphs 4,10, 29; available at http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=27433&SearchText.

[33] *See* NPR, *supra* note 1, 76 Fed. Reg. at 4762; *see also* Akin Gump Letter (Oct. 28, 2010), available at http://www.cftc.gov/ucm/groups/public/@swaps/documents/dfsubmission/dfsubmission26_102810-akingump.pdf.

[34] *Id.*

The AMG respectfully recommends that, before withdrawing the Independent Account Controller Safe Harbor for financial entities, the Commission establish further evidence justifying its concerns regarding the threat of fraudulent circumvention. The Independent Account Controller Safe Harbor has operated for decades without apparent evidence of failure or abuse. Moreover, information and control barriers are widely recognized by other regulators as effective protection against unlawful sharing of information or acting in concert. There are numerous examples of regulatory provisions that recognize the effectiveness of information barriers within financial entities;[35] one example with particularly similar objectives to those underlying the Proposed Rules is Rule 105 of Regulation M, "Short Selling in Connection with a Public Offering," intended to "protect . . . the independent pricing mechanism of the securities market so that offering prices result from the natural forces of supply and demand."[36] In 2007, the SEC amended the rule to (i) treat purchases and sales in separate accounts of a given person as separate if decisions are made separately and without coordination; and (ii) treat purchases and sales by affiliated registered investment companies, or by series of a given investment company, as separate from one another, whether or not they have separate controller procedures, because in its view concerns regarding concerted action were adequately addressed by existing regulation under the Investment Company Act.[37] Simply put, the Commission should not be concerned about coordinated action where information is not shared.

We would argue that a more efficient means of deterring fraudulent activity would be to enhance detection and enforcement remedies. For example, circumvention of position limits to manipulate markets is both a civil and a felony criminal violation of the CEA punishable by civil and criminal penalties, including imprisonment.[38] Eliminating the Independent Account Controller Safe Harbor, on the other hand, might reduce the chance of hypothetical future malfeasance, but it would do so at the cost of severely limiting extensive legitimate trading activity that poses none of the dangers that the NPR cites, with consequent harm to liquidity, hedging costs, and potentially to market stability.

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[35] For example, in interpreting Sections 13(d) and 16(a) of the Securities Exchange Act of 1934, the SEC has said that it "recognizes that certain organizational groups are comprised of many different business units that operate independently of each other. . . . The need to aggregate [would] have the effect of requiring diverse business units to share sensitive information, when it is not otherwise necessary for business purposes. . . . In those instances where . . voting and investment powers over the subject entities are exercised independently, attribution may not be required" for purposes of determining whether an person has exceeded Section 13(d) or 16(a) ownership thresholds. *See* SEC Release No. 34-3958 (Jan. 12, 1998), text accompanying notes 28-32, available at http://www.sec.gov/rules/final/34-39538.txt; *see also* Section 15(g) of the Securities Exchange Act of 1934 (requiring broker-dealers to establish procedures to prevent the misuse of material nonpublic information, generally implemented through procedures entailing information barriers).

[36] *See* SEC Release No. 34-56206 (Aug. 6, 2007), text accompanying notes 1-3, available at http://www.sec.gov/rules/final/2007/34-56206.pdf.

[37] *See id.*, text accompanying note 71; SEC Press Release 2007-120 (June 21, 2007), available at http://www.sec.gov/news/press/2007/2007-120.htm; *see also* Rules 105(b)(2) and (b)(3) of Regulation M.

[38] *See* Sections 6(c) and 13(a) of the CEA.

IV. If the Commission proceeds to adopt limits, it should consider safe harbor treatment for (1) diversified, unleveraged funds and accounts that take passive, long-only positions, and (2) registered investment companies and ERISA and similar accounts.

In determining the appropriateness of position limits as applied to different classes of traders, and how best to exercise its authority to set different limits for different classes and to "exempt, conditionally or unconditionally, any person or class of persons," the AMG would encourage the Commission to take into account the particular characteristics of different trader classes[39] and the fact that certain entities simply do not raise concerns of the type that the Commission has put forward to justify the imposition of limits. As described in the AMG Prior Letter, and in light of comments of members of Congress, we reiterate our request for (1) diversified, unleveraged funds and accounts that take passive, long-only positions, and (2) funds that are registered under the Investment Company Act (**"RICs"**) and accounts that are governed by the Employee Retirement Income Security Act (**"ERISA"**) or similar laws (referred to collectively herein as **"Benefit Plan Accounts"**).[40]

Importantly, the AMG believes that these proposed safe harbors would benefit all market participants and the goals of the Dodd-Frank Act. These funds and accounts provide a valuable service by providing small investors an efficient and low-cost means of access to commodities markets.[41] Overly expansive regulation would limit funds' and accounts' ability to use commodity derivatives, and would in effect tax them with compliance costs that, in the AMG's view, do not offer a countervailing benefit. The expected result would be more limited availability and higher cost to small investors of an important portfolio diversification tool. Further, in curtailing the size of the positions of these funds and accounts, the Proposed Rules would narrow the universe of liquidity providers available to take the other side of commercial hedgers' positions, potentially resulting in higher transaction pricing for derivatives market participants generally.

A. Diversified, unleveraged investment funds and accounts that take passive, long-only positions do not engage in the type of activity that warrant imposition of position limits.

In her December 16, 2010 letter to Chairman Gensler, Sen. Lincoln urged that, in its determination of position limits "'as appropriate' across all markets,"

> the CFTC not . . . unnecessarily disadvantage market participants that invest in diversified and unleveraged commodity indices. These investors often serve as important, collateralized sources of liquidity. At the same time, they are natural counterparties to producers who are seeking to reduce their commodity price risk.

[39] *See* Letter from Sen. Agriculture Committee Chairman Blanche Lincoln to Hon. Gary Gensler (Dec. 16, 2010; filed Jan. 16, 2011) (the "**Lincoln Letter**"), available at http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=27366&SearchText= ("I repeat my request again today. As it contemplates position limits, I encourage the CFTC to carefully consider how such limits may impact particular types of investment vehicles and classes of investors.")

[40] *Id.*; *see also* the Bachus/Lucas Letter, *supra* note 22.

[41] *See* the Lincoln Letter, *supra* note 39.

> In this vein, as I have said previously, it is "my expectation that the CFTC will address the soundness of prudential investing by pension funds, index funds and other institutional investors in unleveraged indices of commodities that may also serve to provide agricultural and other commodity contracts with the necessary liquidity to assist in price discovery and hedging for the commercial users of such contracts."
>
> In addition . . . diversified, unleveraged index funds are an effective way [for investors] to diversify their portfolios and hedge against inflation. Unnecessary position limits placed on mutual fund investors could limit their investment options, potentially substantially reduce market liquidity, and impede price discovery.[42]

The AMG strongly agrees with Sen. Lincoln that the sound and prudent nature of investing by diversified, unleveraged investment funds and accounts that take passive, long-only positions (collectively, **"Diversified Funds/Accounts"**) warrants differential treatment under position limits rules. As discussed in further detail in the AMG Prior Letter, we recommend that the Commission consider safe harbor treatment exempting Diversified Funds/Accounts from position limits.

Diversified Funds/Accounts invest in commodities as an asset class, generally tracking an index and measuring their positions based upon that index and investors moving in and out of the fund, rather than expressing speculative long or short views on particular commodities. More simply put, these funds and accounts provide a means for investing in commodities generally instead of a means for speculating on the performance of particular commodities. The size of the commodity derivative positions held by Diversified Funds/Accounts at any given time is largely determined by individual investors' movements into or out of the funds. Position fluctuations typically occur in relatively modest percentage changes, rather than in volatile shifts that would prompt the types of concerns that the Commission has associated with concentrated positions, as discussed above. These funds often utilize pre-determined rebalancing algorithms, which provide liquidity for commodities that have declined in value during a prior period and thus tend to invest in commodities when prices have decreased and liquidate other positions when prices have increased. Diversified Funds/Accounts typically roll over contracts from period to period, in many cases only to non-spot months, rather than actively trade in and out of markets.[43]

Diversified Funds/Accounts are distinguishable from the "massive passives" cited by Commissioner Chilton as posing price volatility concerns.[44] The "massive passives" tend to target a particular commodity type, whereas Diversified

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[42] *See* the Lincoln Letter *supra* note 39; Commissioner Dunn has also expressed similar skepticism as to the effect that index funds may have on price volatility. *See* Dunn January 13 Statement, *supra* note 3 ("Price volatility exists in markets that have substantial participation from index funds and markets that do not have any index fund participation whatsoever.")

[43] *See* AMG Prior Letter, *supra* note 2, at 6.

[44] *See, e.g.,* Speech of Commissioner Bart Chilton at Notre Dame University (Nov. 1, 2010), available at http://www.cftc.gov/PressRoom/SpeechesTestimony/CommissionerBartChilton/opachilton-34.html.

Funds/Accounts generally seek to provide diversified exposure to commodities as an asset class, often as just a portion of a broadly diversified asset portfolio. As such, they are important long-term sources of liquidity to end-users and other physical market participants that enhance stability and price discovery in commodity swap markets.

The AMG would propose that the Diversified Fund/Account safe harbor be limited to funds and accounts that are not leveraged. As noted in the AMG Prior Letter, unleveraged funds do not present the same market pressure in the event of a forced liquidation of the fund that the Commission is concerned about,[45] and are in fact less likely to liquidate in the first place.

B. Registered investment companies and Benefit Plan Accounts are subject to regulation and oversight that significantly mitigates any risk of inappropriate or disruptive speculation.

The AMG Prior Letter discusses in detail the reasons why the AMG believes that the carefully regulated nature of RICs and Benefit Plan Accounts effectively obviates the risks of excessive speculation and market manipulation which position limits are intended to address.[46] In particular:

Limits on Leverage. RICs are severely limited in the amount of leverage they can obtain, including through the use of derivatives, by the Investment Company Act and related guidance, which requires a RIC to segregate liquid assets or hold offsetting positions on its books in an equivalent amount. [47] Benefit Plan Accounts tend to be unleveraged and, while not subject to specific prohibitions on borrowing, are required to be managed under a strict prudence standard and in a manner that diversifies investments so as to minimize the risk of large losses.[48] The AMG believes that traders that are not leveraged do not pose the risk of price destabilization in the event of a liquidation like those that have occurred in the past when highly leveraged traders have suffered losses.

Limits on Concentration. RICs and Benefit Plan Accounts are subject to requirements that tend to preclude them from taking concentrated positions in a given commodity derivative. RICs that elect to be "diversified companies" are required to meet

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[45] The Commission states in the NPR that large concentrated positions "can potentially facilitate price distortions given that the capacity of any market to absorb the establishment and liquidation of large positions in an orderly manner is related to the size of such positions relative to the market." NPR, *supra* note 1, 76 Fed. Reg. at 4755. Unleveraged funds and accounts present much less of a risk of market destabilization in the event of their liquidation than a highly leveraged fund such as the Amaranth natural gas fund.

[46] *See* AMG Prior Letter, *supra* note 2, at 7-8.

[47] Section 18(f) of the Investment Company Act; *see also* Securities Trading Practices of Registered Investment Companies, Investment Company Act Release No. 10666 (Apr. 18, 1979); Merrill Lynch Asset Management, L.P., SEC No-Action Letter (July 2, 1992); Dreyfus Strategic Investing & Dreyfus Strategic Income, SEC No-Action Letter (June 22, 1987).

[48] Section 404(a)(1) of ERISA.

strict portfolio diversification requirements.[49] RICs that seek to maintain favorable "regulated investment company" tax status are also significantly limited in their ability to concentrate their portfolios under Subchapter M of the Internal Revenue Code of 1986.[50] In addition, RICs generally limit exposure to any single counterparty to five percent of total fund assets, in order to comply with limits under Section 12(d)(3) of the Investment Company Act.[51] ERISA, as noted above, requires fiduciaries to diversify investments so as to minimize the risk of large losses.[52]

V. Rolled positions should be grandfathered from any position limits adopted by the Commission.

Index and other funds and accounts and typically replace or "roll over" their contracts in a staggered manner, before they reach their spot months, in order to maintain position allocations in as stable a manner as possible and without causing price impacts. The AMG respectfully requests that the Commission consider extending the proposed exemption for pre-existing positions to include roll-overs of positions that were established in good faith prior to the effective date of any limit rule. If rolled positions are not grandfathered, funds and accounts could be prevented from implementing roll-overs in the most advantageous manner, and could conceivably be put in the anomalous position of having to liquidate positions to return funds to investors if pre-existing positions cannot be replaced as necessary to meet stated investment goals. This consequence would be directly at odds with the urging of Congressmen Bachus and Lucas that the Commission "use the exemptive authority granted by the [Dodd-Frank] Act to avoid establishing position limits which would force widely-held funds or firms to divest their current holdings in highly regulated products."[53]

The AMG also requests that the Commission clarify that, as stated in Proposed Rule 151.9(a) but counter to what appears to be stated in the NPR,[54] the grandfathering date for both futures and swaps would be the effective date of any position limit rule and not of the Dodd-Frank Act. For the sake of legal and operational certainty the AMG believes that it is important that any limits not affect positions taken prior to rule effectiveness, and that all derivatives contracts, swaps as well as futures, be accorded equivalent treatment.

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[49] Per Section 5(b)(1) of the Investment Company Act, diversified companies cannot invest more than five percent of total capital in any single issuer, and must invest at least 75 percent of total assets in cash and securities.

[50] *See* AMG Prior Letter, *supra* note 2, at 8.

[51] *See* AMG Prior Letter, *supra* note 2, at 7.

[52] Section 404(a)(1)(C) of ERISA.

[53] *Id.*

[54] NPR, *supra* note 1, 76 Fed. Reg. at 4763.

VI. The bona fide hedging exemption to any position limits adopted by the Commission should include economic risk mitigation.

The AMG understands from the NPR[55] that the Commission feels constrained by the statutory language of Section 737 of the Dodd-Frank Act to interpret "bona fide hedging" in a manner that precludes financial hedging. As submitted in the AMG Prior Letter,[56] we believe that this interpretation of "bona fide hedging" is not in fact mandated by Section 737 and would have harmful consequences, including hindering market participants from shifting unwanted risks to those who are willing to undertake it, particularly in light of the legislative history.

In particular, as discussed in the AMG Prior Letter, we would disagree that the omission of "normally" (as used in current Rule 1.3(z), which provides that bona fide hedging transactions "normally represent a substitute for transactions to be made . . . in a physical marketing channel") from new Section 4a(c)(2) compels a conclusion that Congress intended that financial hedging be excluded from the hedging definition. The legislative history indicates that the language emphasizing physical market transactions originated with the House Agriculture Committee's version of the Dodd-Frank Act, and was motivated by a concern that overly strict position limit rules could be injurious to agricultural and other end-users.[57] The AMG believes the "physical market" language was intended to *clarify* that physical market participants would continue to be exempt in their hedging activities, and not to exclude other types of participants from the hedging exemption. This interpretation is corroborated by the Bachus/Lucas letter, which was co-written by the Ranking Member of the House Agriculture Committee that authored the statutory bona fide hedging language, and strongly cautions against overly strict position limits.[58] Against this background we believe it is incorrect to interpret the Dodd-Frank language as requiring an interpretation that is sharply narrower than the common understanding of "hedging" which, per the Commission's current interpretation "would include . . . asset/liability risk management, security portfolio risk, etc."[59]

If the Commission determines that it is unable to continue to interpret "bona fide hedging" in this manner, we would respectfully request that it consider: (a) using its exemptive authority under CEA § 4a(a)(7) to exempt hedging transactions determined by the Commission to be economically appropriate to the reduction of risks in the conduct of a market participant's enterprise; and (b) interpreting netting in a more flexible manner that would take broader forms of offsetting, risk-reducing positions into account. The CEA makes clear that position limits are not to be applied to positions that are not

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[55] NPR, *supra* note 1, 76 Fed. Reg. at 4761.

[56] *See* AMG Prior Letter, *supra* note 2, at 10-11.

[57] *See* AMG Prior Letter, *supra* note 2, note 26 and accompanying text.

[58] Bachus/Lucas Letter, *supra* note 22.

[59] *See* CFTC Form 40, Part B, Item 3 and Schedule 1.

speculative, and we would encourage the Commission to treat financially hedged positions in a manner that is consistent with the CEA's intent.[60]

The AMG further believes that the Proposed Rules create excessive procedural and notification burdens for traders that enter into exempt bona fide hedges. Notwithstanding that the Proposed Rules limit permitted hedges to very specific transactions and positions,[61] exempt treatment is conditioned on participants' filing detailed reports with the Commission for each position, *and for each day* that such position is maintained and the bona fide hedge exemption is relied on. The AMG is concerned that the sheer burden of complying with this requirement, together with the related proposed administrative requirements of the bona fide hedging exemption, could deter participants from taking hedge positions. We believe such a result would be at odds with CEA Sec. 4a(c)(1) which, in prohibiting the Commission from applying limits to bona fide hedging transactions, indicates Congress's intent that position limits not inhibit market participants from engaging in bona fide hedging.

VII. A "position points" regime should not be implemented without a formal rulemaking process.

The AMG is also concerned about the "position points" regime that was suggested by Commissioner Chilton at the Commission's December 16, 2010 public meeting and by Chairman Gensler in his statement in support of the NPR.[62] Under this regime, the Commission may monitor trading positions larger than a pre-established "position point" and "use all available authorities" to require the reduction of certain of these positions. We note that there has been no public notice or comment period in connection with this proposal. Any "position points" regime, including any required reduction of significant positions, should not be implemented without a formal rulemaking process, or otherwise risk violating the Administrative Procedures Act.[63]

There is a significant lack of clarity as to what the position points directive will entail, how it would be implemented and its potential effects on market participants. It is unclear at this point what the Commission's intended course of action would be if it believed a trader's position was too large. The AMG is supportive of the Commission's efforts to survey the size of commodities markets, however, to our knowledge, taking action against participants with large positions would exceed the boundaries of the

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[60] Limiting hedging in the manner set forth in the Proposed Rules would not serve any of the enumerated purposes of position limits as it would limit activity that is not speculative or manipulative. *See supra* note 4.

[61] *See* Proposed Rule 151.5(a)(2).

[62] *See* Commissioner Bart Chilton, "Position Points" (Dec. 16, 2010), available at http://www.cftc.gov/PressRoom/SpeechesTestimony/chiltonstatement121610.html; Commissioner Bart Chilton, Statement Regarding Position Limits and Interim Position Points (Jan. 4, 2011), available at http://www.cftc.gov/PressRoom/SpeechesTestimony/chiltonstatement010411.html; Chairman Gary Gensler, Statement on Support of the Dodd-Frank Rulemaking of Chairman Gary Gensler (Jan. 13, 2011), available at http://www.cftc.gov/PressRoom/SpeechesTestimony/genslerstatement011311b.html.

[63] As Commissioner O'Malia states, "the new 'position points' directive operates as a Trojan horse by attempting to articulate a requirement of general applicability without providing an opportunity for public notice and comment." O'Malia January 13 Statement, *supra* note 7.

Commission's current authority. Accordingly, we request that the Commission's efforts in this area be limited to market surveillance only, unless a "position points" regime is otherwise adopted through a formal rulemaking process allowing for public notice and comment.

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The AMG thanks the CFTC for the opportunity to comment on proposed rulemaking concerning position limits. The AMG would welcome the opportunity to further discuss our comments with you. Should you have any questions, please do not hesitate to call the undersigned at 212-313-1389.

Sincerely,

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