June 20, 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 "**Commission**") with certain additional 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**"). These comments and recommendations are principally directed at the Commission's proposed new account aggregation standards and supplement the AMG's comment letter dated March 28, 2011 (the "**AMG Prior Letter**").[2]

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 noted in the AMG Prior Letter, 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, as we also noted, position limits 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

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1 Position Limits for Derivatives, 76 Fed. Reg. 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 Mar. 28, 2011), available at http://www.sifma.org/Issues/item.aspx?id=24149.

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. Because the Commission's aggregation policy determines whether a market participant must treat positions in different accounts as its own for purposes of complying with position limits, the AMG believes that these issues are closely intertwined and that the combined effect of the Commission's proposed position limits, the proposed limited application of the bona fide hedging exemption, and the novel and burdensome proposed new account aggregation standards would have a serious adverse effect on market liquidity.

We renew all of the comments raised in the AMG Prior Letter, but in view of the Futures Industry Association's ("**FIA**") supplemental comment letter dated May 25, 2011 (the "**FIA Comment Letter**"), in which the AMG concurs, we are reiterating and expanding upon our comment raised in the AMG Prior Letter that the Commission should not require the aggregation of positions among managed funds and accounts where such funds and accounts are separately owned and controlled.[3]

The FIA Comment Letter sets forth the serious concerns presented by the Commission's apparent intention to require the common parent of an integrated group of financial service companies to aggregate all positions traded by its futures commission merchant ("**FCM**") and dealer subsidiaries on its behalf with positions traded independently by its walled-off asset management subsidiaries on behalf of their third party clients due to the ultimate common ownership of the companies. The AMG fully shares these concerns, including the lack of appropriate notice regarding the intended application of the FCM exemption, the novel and unprecedented mixing of the ownership and control criteria, and the apparent reinterpretation of the control criterion. As set forth in the FIA Comment Letter, the AMG emphatically agrees that, if adopted, such an aggregation standard would have a highly detrimental impact on the markets and market participants, with severe consequences for asset management firms and their clients.

Upon review of the FIA Comment Letter and our further analysis of the Proposed Rules, the AMG again strongly urges the Commission to revisit the approach apparently intended with respect to its aggregation policy. In this regard, the AMG requests that the Commission expand the owned non-financial entity exemption to financial entities that meet the same criteria and retain the independent account controller exemption, as requested in the AMG Prior Letter. See Part I of this letter. In addition, the AMG separately requests that the Commission continue to permit disaggregation of positions in separately owned funds and accounts, particularly where common ownership of the positions as well as common control of the trading decisions do not exist. See Part II of this letter.

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[3] We also renew the comments raised in the AMG Prior Letter, including (i) that it is premature to adopt any limits without adequate data on open interest in the commodity swaps market and sufficient studies of the impact of speculative limits on price, volatility and liquidity; (ii) limits, when established, should not be overly restrictive; (iii) safe harbors should be considered for registered investment companies, ERISA and similar accounts, and funds and accounts that are diversified and unleveraged and take passive, long-only positions; (iv) expansion of the bona fide hedging exemption; and (v) that the Commission should not require the aggregation of positions among separate managed funds and accounts.

I. The Commission's proposal to require aggregation of the positions of all entities that share a 10% or greater ownership interest (regardless of control) is unduly rigid and disregards independent management that frequently exists between and among entities that may have common ownership.

The AMG strongly believes that entities that operate separately and independently from one another should not have to combine their trading positions pursuant to a rigid and inflexible aggregation requirement, which would in any event do nothing to address the Commission's concern about preventing excessive speculation and manipulation. In such cases the Commission staff has historically confirmed that a passive investment in another entity does not require the acquiring entity to aggregate the futures positions that may be held by the other entity, absent any indicia of control over the other entity's trading activities. Like the Commission, other federal regulators have generally provided for disaggregation of holdings of financial companies where positions are independently controlled or where appropriate information barriers are in place.[4]

Indeed in the NPR, the Commission has proposed an exemption in the Proposed Rules referred to as the "owned non-financial entity exemption", which would permit an entity to disaggregate its own positions from those of an entity in which it owns a 10% or greater ownership or equity interest if such entity is independently controlled and managed.[5] The Commission states that this exemption is intended to allow disaggregation of a holding company that has a passive ownership interest in one or more operating companies. The Commission states further that it would be inappropriate to aggregate positions where an operating company has complete trading and management independence from the holding company. The AMG agrees with the Commission. However, nowhere in the NPR does the Commission explain why financial entities for which the operating companies may have complete trading and management independence from the holding company, including asset management subsidiaries or the operating companies that they make investments in, should not equally be eligible for a similar exemption. If traders are truly independent, whether they are financial or non-financial entities, the Commission should treat them as such and each such entity should be eligible for its own separate limit. The AMG believes that this principle should apply, whether an entity is trading for itself or for third party clients, where of course common ownership of the positions does not exist.

Moreover, in contrast to non-financial companies, financial entities are generally heavily regulated and as noted in the AMG Prior Letter, are already frequently subject to information barriers to address regulatory, contractual or fiduciary concerns. The Commission clearly has endorsed the use of information barriers as an effective safeguard in preventing the unlawful sharing of information or preventing affiliated entities from acting in concert. In this regard, the Commission recently proposed establishing information barriers to ensure that swap dealers', major swap participants' and FCMs' risk-taking units do not interfere with decisions made by an affiliated clearing firm regarding whether to accept a trade for clearing.[6] Since the Commission is taking the view that information

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[4] *See* Amendments to Beneficial Reporting Requirements, Exchange Act Release No. 34-39538, 63 Fed. Reg. 2854, 2857-58 (January 12, 1998) (noting that "procedures reasonably designed to prevent the flow of information to and from other business units" may be relied upon "to avoid attributing beneficial ownership to the parent entities.").

[5] *See* NPR, *supra note* 1, 76 Fed. Reg. at 4762-4763.

[6] *See* 75 Fed. Reg. at 71391, 71393 (November 11, 2010) and 75 Fed. Reg. at 70152, 70154 (November 17,

barriers are sufficient to protect access to central clearing, the same rationale should permit a financial entity and its affiliated entities that have similar information barriers in place, reflecting separate and independent trading activities and management independence, to disaggregate their positions. Conversely, requiring aggregation could have the counterproductive effect of exacerbating the very concerns regarding concerted action (whether deliberate or inadvertent) that apparently form the basis of the Commission's proposal to eliminate the independent account controller exemption for financial entities under the Proposed Rules.

If the Commission is concerned that information barriers that have been established between commonly owned financial entities may be insufficient for ensuring truly independent trading among affiliated entities, the Commission has other means at its disposal to address this concern more reasonably and appropriately.[7] Moreover, to address any residual concerns regarding the potential evasion of speculative position limits, the Commission may exercise its existing authority to obtain any pertinent information concerning positions and transactions relating to any commodity in which a trader owns or controls a reportable position and also issue a "special call" to obtain any additional information, if necessary or appropriate.[8] Ironically, requiring financial entities to monitor positions across affiliates where information barriers exist may cause them to breach these barriers which have been put in place for regulatory and other valid business purposes, as well as their fiduciary or contractual duties to their clients. Thus, the AMG strongly believes that an exemption applicable only to owned non-financial entities is insufficient, is unsupported by any valid rationale or regulatory concern, and requests that the Commission reconsider this aspect of its proposal.[9]

Consistent with the foregoing, the Commission should continue to permit the existing safe harbor under Rule 150.3(a)(4)(i), often referred to as the "independent account controller exemption", where common ownership of the positions does exist. This exemption has existed in different forms since 1988 and has worked well, without any reported instances of non-compliance with its provisions. The Commission does not explain in the NPR how independently controlled accounts pose a risk of coordinated excessive speculation or manipulation, or how retaining this longstanding exemption would be inconsistent with the Commission's proposed position limits. In view of the lack of adequate rationale in the NPR, the Commission should establish further evidence to justify its concerns before proceeding to curtail the availability of this exemption in such a drastic fashion.

II. The Commission should continue to permit disaggregation where common ownership of positions and control of trading decisions do not exist.

Irrespective of whether the Commission expands the owned non-financial entity exemption to financial entities that meet the same criteria or retains the independent account controller exemption, it is now our impression that the Commission intends to require the aggregation of positions even where common ownership of the positions <u>and</u> common control of the trading decisions do not exist, including

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2010).

[7] As set forth in the AMG Prior Letter, a more effective means of deterring fraudulent activity would be to enhance detection and enforcement remedies.

[8] *See* Commission Rule 18.05 and Commodity Exchange Act § 4(i).

[9] In addition, in order for such an exemption to be workable for applicants and the Commission and its staff, the AMG strongly believes that an exemption should be effective upon filing of an application in good faith.

in the circumstances described in the FIA Comment Letter with respect to the FCM exemption and referenced earlier, but also in other contexts as well. The AMG agrees with FIA that such an aggregation standard is not supported by any fair reading of the Dodd-Frank Act, the Proposed Rules, the Commodity Exchange Act, or the NPR. In the context of asset management firms which utilize sub-advisers to manage client portfolios, or that sub-advise portfolios, whether or not the entities are affiliates, the asset management firms do not exercise day-to-day control of the trading decisions of these sub-advisers and only maintain such minimum amount of control as is consistent with their fiduciary responsibilities to fulfill their duty to supervise the trading done for client portfolios.[10] This also holds true with respect to fund-of-funds structures where the fund-of-funds and the fund-of-funds managers do not control the trading decisions of the external funds in which they invest for client portfolios. This model is widespread in the asset management industry and has been used for decades without any reported instances of intent to evade position limits. Indeed, the Commission has always recognized that an adviser which does not exercise day-to-day control of trading for a client account should not be required to aggregate the positions for purposes of position limits or its large trader reporting requirements.[11] This is because in such circumstances the asset management firms do not control the trading decisions made by the sub-advisers and the sub-advisers are trading separately and independently. Thus, imposing such an aggregation requirement would be a radical change in the Commission's historic policy without any substantive reason and would not advance any regulatory policy or purpose.

The consequences of implementing such an aggregation requirement for asset management firms and their clients would be extremely serious, particularly if limits are set too low. Among other things, all market participants would suffer from a significant reduction in market liquidity, the consequential increase in costs to market participants, and also the negative impact on investment returns and their ability to accomplish legitimate investment and risk management strategies. It should also be emphasized that other federal regulators have followed the same approach as the Commission's longstanding policy and continue to do so, including the Securities and Exchange Commission with respect to securities ownership under Sections 13 and 16 of the Securities Exchange Act of 1934, as amended (the "**Exchange Act**").[12] Such a massive departure from longstanding policy without an adequate rationale and without appropriate notice inevitably will have unforeseen adverse consequences.

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[10] Of course, if an asset management firm retains day-to-day control over the trading of sub-advised accounts, aggregation of those accounts would be required under current law.

[11] *See* Part 150 of the Commission's Rules, (17 C.F.R. Part 150 (2010)) and Part 17 and 18 of the Commission's Rules (17 C.F.R. Part 17, 18 (2010)), respectively.

[12] *See* Exchange Act Rule 13d-3(d)(1).

The AMG thanks the Commission for the opportunity to submit these additional comments and recommendations on the Proposed Rules. Consistent with the FIA Comment Letter, the AMG respectfully requests that the Commission clarify its intention by republishing the Proposed Rules for public comment with an adequate explanation. 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,

Timothy W. Cameron, Esq.
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Securities Industry and Financial Markets Association