

RECEIVED
C.F.T.C.

AUG 16 PM 3:15

RECORDS SECTION



MANAGED FUNDS ASSOCIATION

August 16, 2004

VIA FEDERAL EXPRESS

Ms. Jean A. Webb
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

04-6
7
RECEIVED
C.F.T.C.
2004 AUG 16 PM 2:42
COMMENT

Re: Revision of Federal Speculative Position Limits

Dear Ms. Webb,

Managed Funds Association (MFA) is grateful for the opportunity to provide its comments on the Chicago Board of Trade's (CBOT) pending proposal for the repeal of Federal speculative position limits applicable to certain agricultural futures and option markets (Commission Regulation 150.2 published in *The Federal Register*, Volume 69, Number 166, June 17, 2004).

MFA is the primary US-based membership organization dedicated to serving the needs of professionals worldwide that specialize in the alternative investment industry — managed futures funds, hedge funds and fund-of-funds. MFA has over 750 members who manage a significant portion of the nearly \$1 trillion invested in these alternative investment vehicles globally. MFA's members include commodity trading advisers and commodity pool operators that are major participants in all future markets, including those subject to Federal speculative position limits.

Federal speculative position limits are of vital interest to MFA's members because of the direct impact they have on the management of customer funds committed to the management of commodity trading advisers and pool operators. MFA and its members strongly support the elimination of speculative limits in the following futures and option markets: CBOT corn, oats, soybeans, wheat, soybean oil, and soybean meal; Kansas City Board of Trade (KCBT) hard winter wheat; Minneapolis Grain Exchange (MGE) hard red spring wheat and white wheat; and New York Board of Trade (NYBOT) cotton No. 2. If the Commission does not decide to eliminate these Federal speculative limits, at the very least, MFA and its members believe these limits should be immediately increased.

The elimination of or increase in Federal speculative position limits will have the effect of making the agricultural futures markets in the United States more competitive with exchanges and markets located outside of the United States. Since most foreign futures exchanges do not rely upon speculative position limits as a regulatory device, and because off-exchange markets do not have any position limits applicable

to them, access to domestic markets has been discouraged by the presence of position limits. The development and growth of foreign and off-exchange markets has correspondingly been encouraged as U.S. markets have become less competitive due in part to regulatory constraints such as speculative position limits. MFA also believes that a chilling effect has been created by the presence of speculative position limits: as assets under management increase, traders who use U.S. markets must restrict or eliminate their use of markets where speculative position limits exist or where they are maintained at unreasonably low levels.

For all of the foregoing reasons, MFA urges the Commission to proceed promptly with either the elimination of or increase in Federal speculative position limits. Should the Commission not decide to eliminate these Federal limits, MFA encourages the Commission to continue to monitor developments in this area in order to ensure that speculative position limits realistically reflect market conditions. A substantial amount of the material contained in this letter is based on the CBOT's Amended Petition for Amendment of Commodity Futures Trading Commission Regulation 150.2, filed April 27, 2004 (the "CBOT Amended Petition"), and MFA agrees with the positions advocated by the CBOT.

Elimination of Federally Mandated Position Limits

Regulation 150.2 establishes speculative position limits for named agricultural contracts that are traded on specifically identified designated contract markets. MFA supports the findings set forth in the CBOT Amended Petition, and joins the CBOT, the KCBT, the MGE and the NYBOT in requesting that all Federally mandated position limits be eliminated from Commission Regulations and that Regulation 150.2 be repealed.

CFMA

Since 1999, Congress has passed the Commodity Futures Modernization Act of 2000 ("CFMA"). The CFMA replaced a rules-based approach to regulation with a more flexible model based upon compliance with Core Principles. Core Principle 5 of Section 5(d) of the Commodity Exchange Act, as amended ("CEA"), applicable to designated contract markets, deals with Position Limitations or Accountability, and states that:

To reduce the potential threat of market manipulation or congestion, especially during trading in the delivery month, the board of trade shall adopt position limitations or position accountability for speculators, where necessary and appropriate ("Core Principle 5").

Therefore, although the Commission retains the authority to set speculative position limits pursuant to Section 4a(a) of the CEA, the most recent pronouncement of Congressional intent as set forth in the CFMA's Core Principles squarely places responsibility for establishing position limits upon the exchanges.

The fact that the Commission set speculative position limits for the agricultural contracts listed in Regulation 150.2, and left the responsibility to set all speculative position limits for other products, including other agricultural products, to the exchanges under Regulation 150.5, appears to be a matter of historical development, and not based upon any distinctions applicable to the enumerated contracts. For example, in the Federal Register release accompanying the adoption of the current single-month and all-months levels for CBOT and other exchange contracts, the Commission stated that it had never established a speculative position limit for the Minneapolis Grain Exchange's former durum wheat contract, because that contract was listed after the promulgation of the Commission rule that required contract markets to set their own speculative limits for contracts not subject to limits set by the

Commission. The Commission further stated that since the adoption of that rule, it has generally preferred to rely upon exchanges to set their own position limits. Revision of Federal Speculative Position Limits and Associated Rules, [1998-1999 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶27,608, at 47,884, fn. 9 (64 F.R. 24038, May 5, 1999).

In fact, even before the passage of the CFMA and the adoption of the Core Principles, the CBOT suggested granting the exchanges sole responsibility to establish and monitor speculative position limits subject to Commission oversight. At that time, the Commission responded that it “. . . believes that this suggestion may merit future consideration.” Revision of Federal Speculative Position Limits and Associated Rules, [1998-1999 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶27,608, at 47,882-47,883, fn. 7 (64 F.R. 24038, May 5, 1999). The time has now come for the Commission to grant the sole responsibility to establish speculative position limits to the exchanges by repealing Regulation 150.2, and for the Commission to oversee the exchanges’ exercise of that responsibility, as envisioned by the CFMA.

MFA continues to believe that position limits are not necessary or efficient in detecting or combating market manipulation and price anomalies. Moreover, the continued maintenance of unnecessarily low position limits has the anti-competitive effect of limiting access to U.S. markets and encouraging market participants to trade away from U.S. exchanges, whether on foreign futures exchanges or through off-exchange instruments. This diversion of trading activity to other markets reduces the hedging and price discovery functions of U.S. markets, while also discouraging the development of competitive products and markets in this country.

Alternative 1: Elimination of Single-Month and All-Month Limits from Regulation 150.2

While MFA believes that the elimination of all Federally established speculative position limits is in the public interest in competitive and liquid markets, it would support as the next best alternative the elimination of the single-month and all-month limits.

In Appendix B to Part 38 of its Regulations, the Commission has discussed certain acceptable practices that would satisfy Core Principle 5. The Commission specifically noted that provisions concerning speculative position limits are set forth in Part 150 of its Regulations. However, in discussing “. . . markets based on commodities having more limited deliverable supplies or where otherwise necessary to minimize the susceptibility of the market to manipulation or price distortions”, the Commission focused on spot-month limits. The discussion concluded with the Commission’s only reference to non-spot month limits, in which it stated that “[m]arkets may elect not to provide all-months-combined and non-spot month limits.” Appendix B to Part 38, Core Principle 5 of section 5(d) of the Act, Paragraph (b)(4).

Therefore, although in its Regulation 150.2, the Commission has historically imposed single-month and all-months position limits upon certain agricultural commodities, the Commission has now explicitly recognized that, for similar markets, such limits are not necessary to minimize the potential for manipulation or price distortion. In light of the adoption of Core Principle 5 as part of the CFMA, and the Commission’s applicable Appendix B guidance, there appears to be no reasonable distinction between the agricultural commodities addressed in Regulation 150.2, and other commodities that have “more limited deliverable supplies”, that would support any need for the Commission itself to set single-month and all-months position limits for such commodities.

Therefore, even if the Commission determines to continue to impose its own spot month limits, MFA requests that the Commission amend Regulation 150.2 to eliminate all single-month and all-months limits, and rely upon the exchanges to impose limits that are necessary and appropriate, subject to Commission oversight.

Alternative 2: Regulation 150.2 should be amended to Increase Single-Month and All-Month Speculative Position Limits

If the Commission determines to retain single-month and all-months position limits for the identified agricultural products in Regulation 150.2, MFA requests, as a second alternative, that the Commission raise those limits because they have been rendered inappropriate by the dynamic growth in those futures and options markets. The continuation of unnecessarily low position limits has imposed an artificial restriction on market liquidity, making the relevant futures markets less effective for hedging and for the performance of the markets' price discovery function.

MFA supports the arguments contained in the CBOT's Amended Petition. First, the CBOT's survey concluded that a majority of a broad cross-section of the agricultural trading community supports an increase in speculative position limits. Furthermore, the CBOT correctly illustrates why the proposed increases are justified by the application of the percentage of open interest formula that has been adopted by the Commission as the appropriate method for determining the levels of single-month and all-months speculative position limits. Finally, the distribution of large trader positions in the relevant markets lends added support to justify the proposed increases.

Conclusion

MFA requests that the Commission repeal Regulation 150.2 for the reasons above. If the Commission determines to retain the spot month limits set forth in Regulation 150.2, MFA requests that the Commission eliminate all single-month and all-months-combined speculative position limits from Regulation 150.2. If the Commission determines not to eliminate all single-month and all-months-combined speculative limits, MFA requests that the Commission amend Regulation 150.2 to raise the single-month and all-months limits. Finally, should the Commission not eliminate speculative limits, MFA believes it is imperative that parity be maintained across the wheat exchanges, as has been done by the Commission historically.

MFA commends the Commission for its efforts in monitoring the issue of Federal speculative position limits and for its consideration of the CBOT Amended Petition and the submissions of the supporting exchanges. MFA is optimistic the Commission will agree that these limits should be repealed or revised. If you have any questions regarding these comments or would like to discuss them, please call me at (202) 367-1140.

Sincerely,

John G. Gain
President

cc: Acting Chairperson Sharon Brown-Hruska
Commissioner Walter L. Lukken