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Commodity Futures Trading Commission
Commission Actions in Response to the "Comprehensive Review of the Commitments of Traders Reporting Program" (June 21, 2006)

December 5, 2006

I. Introduction

The Commitments of Traders ("COT") reports are weekly reports, published by the Commodity Futures Trading Commission ("CFTC" or "Commission"), showing aggregate trader positions in certain futures and options markets. Over time, both the trading activity that is the subject of the COT reports, and the reports themselves, have continued to change and evolve. As part of its ongoing efforts both to maintain an information system that reflects changing market conditions, and to provide the public with useful information regarding futures and options markets, the Commission, on June 21, 2006, published a document entitled, "Comprehensive Review of the Commitments of Traders Reporting Program."[1] The document (hereafter referred to as the "request for comments") was intended to: (1) provide useful background information regarding the COT reports; (2) lay out various issues and questions regarding the COT reports; and (3) solicit public comment regarding the reports, including suggestions as to possible changes in the COT reporting system.

This document will: (1) briefly summarize the issues discussed in the request for comments; (2) describe the commenters and review the comments received in response to the request for comments; and (3) describe the actions the Commission will take in addressing the issues raised in the request for comments. In a nutshell, the Commission's response to the comments, and its review of COT issues, will consist of the following actions:

1. The Commission will continue to provide the COT reports it currently publishes,[2] covering over 90 U.S. commodity markets, with no changes in the form, format, or timing;

2. On January 5, 2007, the Commission will begin publishing an additional COT weekly report entitled "COT—Supplemental;"

3. The new report will show aggregate futures and option positions of Noncommercial, Commercial, and Index Traders in 12 selected agricultural commodities;[3] and

4. The new report will be published on a two-year, pilot program basis.

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[1] 71 FR 35627 (June 21, 2006).
[2] The Commission currently publishes four weekly COT reports: Futures-Only Commitments of Traders (both long form and short form); and Futures-and-Options-Combined Commitments of Traders (both long form and short form).
[3] In order to put the data in the new COT—Supplemental report in context, the Commission will publish, contemporaneously with the new report, comparable weekly data for 2006 for the 12 markets covered by the report.

During the pilot program period, the Commission will review whether, and if so how, to improve the report.

II. Issues Discussed in the Request for Comments[4]

The request for comments described the history and evolution of the COT reports. Over time, for some commodities the nature of the positions carried in the COT reports has changed significantly. Prior to 1991, both the long and the short side of the commercial open interest listed in the COT reports represented traditional hedgers (producers, processors, manufacturers or merchants handling the commodity or its products or byproducts). Since that time, trading practices have evolved to such an extent that, today, a significant proportion of the long-side open interest in a number of major physical commodity futures contracts is held by so-called non-traditional hedgers (e.g., swap dealers), while the traditional hedgers may be either net long or net short (more often, the latter). This has raised questions as to whether the COT report can reliably be used to assess overall futures activity by persons who are directly involved in the underlying physical commodity markets.

In view of the changes in markets and trading patterns described in the request for comments, the Commission sought public comment concerning whether it should adopt any changes to the way data are presented in the COT reports. In an effort to solicit the widest possible range of comments, the Commission also asked whether it should stop publishing the COT reports altogether "if it is determined that either: (1) there are data anomalies in the reports for which no satisfactory solution can be found; or (2) the data in the reports provide no public benefit." The request for comments included a list of 11 specific questions designed to elicit information helpful to the Commission in assessing possible changes to the COT reporting system. The questions are reproduced in the next section of this document, along with a summary of the comments received in response to each question.

III. The Comments Received

A. The Commenters

The Commission received a total of 4,659 comments in response to the request for comments, by far the largest number of comments received in response to any such request ever issued in the agency's 31-year history (the previous record was 1,062 comments). In addition to comments from U.S. residents, the Commission received comments from citizens of Australia, Cambodia, Canada, France, Germany, Hungary, India, Indonesia, Ireland, Italy, Japan, Netherlands, New Zealand, Russia, Singapore, South Africa, Spain, Sweden, Switzerland, Taiwan, Thailand and the United Kingdom.

The vast majority of the comments were from individuals. Some of these commenters provided no indication of their background, status or affiliation. Many, however, included a reference to trading or advisory activity for which they depend on the COT reports. Several academics also commented, including mostly professors of finance or economics.

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[4] The discussion in this section is a brief summary. For more details, see the request for comments, 71 FR 35627 (June 21, 2006).

Comments were also received from officers or employees of various firms and organizations. In some cases, the comments were clearly filed on behalf of the firm or organization, but often it was impossible to determine whether these commenters were expressing their individual views or speaking on behalf of their firm or organization. Also, while some comments did describe the firms' business activities, most of these commenters did not provide any description of their firm's business beyond its name. Nevertheless, judging by those firm names and the commenters' titles, it is clear that these firms are generally involved in managing investments for, or providing investment advice to, their clients. Also, a number of comments were received from publications or services that rely on COT data in providing information or analysis to their subscribers or clients.

The Commission also received comments from a number of organizations, including three designated contract markets, the Chicago Board of Trade ("CBOT"), the Minneapolis Grain Exchange ("MGEX") and the New York Mercantile Exchange ("NYMEX").[5] The International Swaps and Derivatives Association ("ISDA") also commented. The Commission received comments from one grain elevator (Holyoke Cooperative Association) and one large grain merchandising firm (Bunge North America, Inc.). In addition, the Commission received comments from a large number of agricultural organizations, including: the American Cotton Shippers Association, the Illinois Farm Bureau, the Missouri Farm Bureau Federation, the National Grain Trade Council ("NGTC"), the National Grain and Feed Association ("NGFA"),[6] the North American Export Grain Association, and – filing a single joint letter – American Soybean Association, National Association of Wheat Growers, National Barley Growers Association, National Corn Growers Association, National Cotton Council, National Farmers Union, National Sorghum Producers, US Canola Association, USA Rice Federation, and US Rice Producers Association ("USRPA"). Finally, the Commission entered into the comment file a transcript of the morning session of the August 1, 2006 meeting of the Commission's Agricultural Advisory Committee ("AAC"). That portion of the meeting included an explanation of the COT request for comments by CFTC staff members, a panel discussion of COT issues among representatives of CBOT, NGFA, NGTC, ISDA and USRPA, and questions and comments concerning COT issues by AAC members.

B. Summary of the Comments Received

The majority of the comments concentrated only on the issues raised in questions 4 and 5 of the request for comments:

> 4. Should the Commission continue to publish the COT reports? [and]
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> 5. If the Commission continues to publish the COT reports, should the reports be revised to include additional categories of data—for example, non-traditional commercial positions, such as those held by swap dealers?

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[5] Comments were also received from individual members of both the CBOT and the New York Board of Trade.
[6] NGFA members, Bartlett Grain and Lortscher Agri Service, Inc., also filed brief comments in support of the NGFA's position.

In response to question 4, the commenters were virtually unanimous[7] in strongly recommending that the Commission continue to publish the COT reports. Many of the comments responded only to the issue raised in question 4. Some simply urged the Commission to maintain the status quo (*e.g.*, "please, please do not discontinue this very valuable report," "please keep the COT," "save the COT," "leave it alone you knuckleheads"). Others recommended that the Commission continue publishing the COT reports, but "increase transparency." Suggestions for increasing the transparency of the COT reports included: revising the COT reporting schedule to publish the (currently weekly) reports twice weekly, daily, hourly, or even in real time; providing spread data for commercial traders; breaking down concentration ratios to show whether the holders are commercials or noncommercials; identifying position holders by name;[8] or publishing data for markets with fewer reportable traders.[9]

In addition to recommending that the Commission continue publishing the COT reports, the majority of the commenters, with one notable exception (ISDA), also responded positively to question 5, suggesting that the reports be revised to include additional data categories. Representative comments included: "include a new category for non-traditional commercials;" "[differentiate] fund or other investment activity from traditional 'commercial' activity;" "create a separate reporting category ... [for] non-traditional traders like funds and swaps;" "[separate] index funds ... from the trading activity of traditional 'commercial' accounts;" "identify a category of ... non-traditional hedge activity, such as financial hedges;" and "please also correct the hedger data ... and reserve the hedger category for traditional hedgers." Many of these commenters also recommended that, if the Commission does implement changes in the COT reports, it should do so "in such a way as to maintain the continuity of historical data [because] absent historical reference, the report becomes nearly unintelligible."

ISDA, in arguing against any changes in the COT reporting system, stated:

> Some commenters, particularly "traditional" agricultural commercial participants, have associated index investor participation in the commodities markets with increased speculation and volatility. ... [However] ... Index investments are passive and predictable, and should not by themselves increase market volatility. This predictability does, however, provide other market participants that anticipate the recurring rolling of index positions with trading opportunities. To the extent that these market participants are provided with more direct and specific information about the position of the passive index providers, they are more likely to engage in speculative trading that increases volatility. Thus, ironically, the more disclosure that is required of "non-traditional" commercial participants the more likely it is that volatility will increase. ... [Therefore] ISDA believes that current public policy is best served by continuing the COT reports in their current form ... [and] strongly recommends against the creation of a new non-

[7] None of the commenters suggested that the Commission should discontinue publishing the COT reports. However, in some cases, the commenter's intent regarding the reports had to be inferred (*e.g.*, it was assumed that the comment reading, in its entirety, "Don't you dare," was intended to mean "Don't you dare stop publishing the COT reports").

[8] Separately disclosing the market position of any person would be in direct violation of Section 8(b) of the Commodity Exchange Act.

[9] Currently, in order to help maintain the confidentiality of position information, COT numbers are only reported for markets in which 20 or more traders have positions at or above Commission reporting levels.

> traditional commercial category. If the Commission decides otherwise, we recommend that any additional reporting be in a no more than two-year pilot program ... with a limited number of commodities.

A much smaller proportion of the commenters responded to some or all of the other nine questions in the request for comments. The remaining questions, and representative examples of the commenters' responses, appear below.

> 1. What types of traders in the futures and option markets use the COT reports in their current form, and how are they using the COT data? More specifically:
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> > (a) How do traders use the COT information on commercial positions?
> > (b) How do they use the COT information on noncommercial positions?
> > (c) In particular, with respect to information on noncommercial positions, what information or insights do traders gain from the COT reports regarding the possible impact of futures trading on the underlying cash market?

The NGFA provided the most comprehensive list of traders who use the COT reports: "farm marketing advisors/brokers; commercial hedging advisors/brokers; FCMs, IBs, and CTAs; cash merchandiser/hedgers or similar decision makers, including end-users, exporters, processors, merchants; [and] OTC dealers or other trading desks." Other commenters cited one or more of the types of entities subsumed in the NGFA list. In addition to such commercial and professional users, as noted above, a great many individual traders commented that they depend on the COT reports in conducting their personal trading.

With respect to the questions regarding how traders use the COT data, many responses were rather general (*e.g.*, "COT reports appear to be widely used ... in analyzing price trends and making trading decisions," "information on noncommercial positions ... [is] widely used as an indicator of trend trading and other speculative fund activity," "these reports allow me as an individual trader ... [to] make judgments based upon overall long and short positions as to the general market direction," "We use it as a key trading input.").

However, several commenters described specific trading strategies based on the COT data (*e.g.*, "In uptrends, the extent that large noncommercial traders are willing to bid forward futures prices to a premium over normal carrying charges gives me an indication of the potential strength and longevity of bullish conditions."). Also, Tom Coyle, of the NGFA, speaking at the August 1, 2006, meeting of the Agricultural Advisory Committee,[10] cited the example of a farmer trying to decide whether to lock in a price for a part of his crop through a futures hedge. He noted that the farmer is "trying to gauge whether or not there is real consumer demand." In the past, the farmer could look at the COT report, which shows the positions of "commercials," and the farmer could rely on the fact that an increase in the long futures positions held by the commercials reflected their sales of the cash commodity, and the farmer could conclude that there would be good demand for the cash grain. Based on that evidence of strong consumer demand, and anticipating a bullish market, the farmer could postpone establishing his short hedge. Today, however, the farmer cannot rely on the COT report to accurately reflect consumer

[10] *See*: Meeting of the CFTC Agricultural Advisory Committee, August 1, 2006, Transcript pp. 85-88.

demand because increases in long open interest shown in the COT report may be based on the positions of "non-traditional commercials," rather than consumer demand. Thus, when the farmer finally does establish a hedge later in the crop year, he finds that demand has not, in fact, grown as the COT report seemed to be telling him, and he is forced to establish his hedge with a less favorable basis than was available earlier in the year. Thus, according to Mr. Coyle, relying on the COT report in today's environment could cause the farmer to lose money.

In summary, a wide variety of both commercial/professional traders and individual traders/speculators depend on the COT reports for a wide variety of uses in planning and conducting their trading activities.

> 2. Are other individuals or entities (academic researchers or others) using the COT reports and, if so, how?

The comments reveal a wide array of persons other than traders who use the COT reports. With respect to academic users, these commenters all apparently use the reports, and several cited specific works (including, one commenter's doctoral thesis) that rely on the reports. Also regarding academic uses, various commenters pointed out that "the Haigh working paper on the CFTC website[11] lists 41 scholarly works, many apparently using COT data." Looking beyond the academic area, the Commission also received comments from a number of advisory publications or information services that rely on COT data in connection with providing information or analysis to their subscribers or clients. A number of the clients who depend on that information, commenting as individual traders, made the same point. In addition, the NGFA comment refers to "farm advisors [who] use the report in developing recommendations for their customers," and journalists who rely on the reports in writing stories about the futures markets. Finally, the CBOT comment notes that, "CBOT research staff also utilizes historical COT data to monitor trends in participation in the Exchange's products by commercial and noncommercial traders."

> 3. Do the COT reports, in their current form, provide any particular segment of traders with an unfair advantage?

Most of the commenters who answered this question did so in the negative (*e.g.*, "NGTC strongly believes that the COT reports do not provide … any segment of the industry with an unfair advantage," "the reports … help to level the playing field between the large players in the market and the small ones," "market transparency is the antithesis of manipulative advantage and the COT report makes US futures the most transparent … in the world."). However, the MGEX notes that the current system "blends noncommercial open interest such as index funds with traditional noncommercial open interest … [and] enables index funds to potentially conceal their positions amongst other market participants within noncommercial activity." The NGFA makes a similar point that "rising open interest on the long side of commercial positions has been misinterpreted as related to export activity and end-user buying … potentially [giving] an advantage to the actual traders behind … some unknown percentage of those positions – the

[11] *See*, "Price Dynamics, Price Discovery and Large Futures Trader Interactions in the Energy Complex," Working Paper, Michael S. Haigh, Jana Hranaiova and James A. Overdahl, April 28, 2005. The scholarly works referred to by the commenters are listed in Section III of the Working Paper, "Literature Review."

'non-traditional commercial' firms." The CBOT states that it does not believe that the COT reports "currently provide any category of trader with an unfair advantage," but suggests that the failure to differentiate between traditional and non-traditional hedgers in the commercial category "may have placed all market participants at a disadvantage with respect to the usefulness of the information ..."

> 6. As a general matter, would creating a separate category in the COT report for "non-traditional commercials" potentially put swap dealers or other non-traditional commercials at a competitive disadvantage (since other market participants would generally know that their positions are usually long, are concentrated in a single futures month, and are typically rolled to a deferred month on a specific schedule before the spot month)?
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> 7. More specifically, if the data in the COT reports are made subject to further, and finer, distinctions, such as adding a category for non-traditional commercials:
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> > (a) Would it increase the likelihood that persons reading the reports would be able to deduce the identity of the position holders, or other proprietary information, from the reports?
> > (b) Could such persons use information gleaned from the reports to gain a trading advantage over the reported position holders?
> > (c) In such case, in order to reduce the likelihood of publishing categories with few traders, which might provide information giving other traders a competitive advantage over the reported traders, should the Commission consider raising the threshold number of reportable traders needed to publish data for a market from 20 traders to some larger number of traders?

Most of the commenters addressing these questions expressed opinions along the lines of: "we do not believe creating a separate category ... to reflect 'non-traditional commercial' activity would put any market participants at a disadvantage;" "NGTC does not believe that adding a category ... for non-traditional, or financial, hedgers would enable the identification of specific firms' positions or otherwise reveal any relevant proprietary information;" and "the COT report is not the only source of information regarding the potential size and timing of investment fund rolls. Even if it were, the market would soon arbitrage out any unfair advantage." The commenters expressing such views also generally agreed that the current threshold requirement, that there must be at least 20 reportable traders in a given market before the Commission publishes COT data for that market, is more than adequate to protect traders' identities.

On the other hand, ISDA argued that publishing a separate category of non-traditional commercials would allow other market participants to calculate swap dealers' positions through "reverse engineering" and that "... speculators, with such information on non-traditional commercial trends, would gain a competitive advantage allowing them to trade ahead of the swap dealers." While not opposing publication of a separate category of data for non-traditional commercials, NYMEX urged the Commission to "consider carefully whether any future proposed change in the type, quantity or categorization of data could potentially lead to the disclosure of specific traders' activities in a way that unduly disadvantages them." Similarly, the

CBOT stated that, while a separate category for non-traditional commercials "would significantly improve the usefulness of the COT," the Commission should carefully analyze whether such traders would suffer "any potential competitive disadvantage" and "consider any appropriate means to mitigate any such disadvantages in its implementation of revisions to the COT reports." Some of the individual commenters also stated that they "oppose[d] any changes that would put swap dealers or other non-traditional traders at a disadvantage."

> 8. If the data in the COT reports are made subject to further, and finer, distinctions, should the reports be revised for all commodities, or only for those physical commodity markets in which non-traditional commercials participate?
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> 9. If a non-traditional commercial category were added to markets in physical commodities, what should be done with financial commodities, where "non-traditional commercials" would be essentially an empty category (since, in financial commodities, swap dealers would fall within the pre-existing "commercial" category)?

The commenters who responded to these questions expressed a variety of views. Suggestions for the commodity categories that should be subject to the revised reports ranged from just the grain markets, to all (or only) physical commodity markets, to "only ... markets with significant non-traditional participants," to all markets, including financial markets (a category that would currently be populated by a zero, but that would be available for data input in case trading patterns changed), to "use judgment to implement only where it makes sense."

> 10. The Commission has observed that the non-traditional commercials tend to be long only and tend not to shift their futures positions dramatically – even in the face of substantial price movements. If the data in the COT reports are made subject to further, and finer, distinctions, would issuing the additional data on a periodic basis, in the form of a quarterly or monthly supplement, be sufficient?

While a few commenters suggested that monthly or quarterly reports would be sufficient, the vast majority favored publishing any additional data regarding non-traditional commercials on the same schedule as all other COT data (*i.e.*, weekly if the current publication schedule is maintained, or more often if the Commission follows the suggestions of those commenters who recommended more frequent releases of COT data).

> 11. Some reportable traders engage in both traditional (physical) and non-traditional (financial) commercial activity in the same commodity market. If the data in the COT reports are made subject to further, and finer, distinctions, such traders would have to break out their non-traditional commercial OTC hedging activity into a separate account. Would such a requirement represent an undue burden to those traders?

The commenters who responded to this question nearly all expressed the view that the reportable traders described in the question should not find it unduly difficult or burdensome to break out non-traditional hedging activity into a separate account. MGEX suggested that the "benefits to the marketplace ... [of] enhanced reporting requirements would outweigh the cause for concern of any potential unforeseen burden." However, none of the commenters expressing such views

identified themselves as reportable traders who actually might be subject to such a potential requirement.

IV. Commission Actions in Response to the Comments

The Commission believes that the current classifications in the COT reports can be improved for certain markets in which commodity index trading has become a significant part of the trading landscape by adding a new category. Historically, the intent of the classification of traders in the COT reports is to class traders according to their general purpose for trading in futures markets. In the past, and for many markets currently, a two-fold classification of reportable traders was, and is, appropriate. Noncommercial traders generally use futures markets to speculate on the future direction of price movements and are generally sensitive to fundamental and/or technical factors that might influence prices. Traditional commercials use futures markets to manage price risk resulting from activity in the underlying cash market. Accordingly, their activity in the futures market conveys information about market conditions in the underlying cash market.

However, commodity index trading has presented a third general purpose for trading in futures markets, *i.e.*, to gain long-side exposure to a broad index of commodity prices as an asset class. This trading is not based on a view about current or expected individual commodity prices, as would be the case for most speculative trading. It is not based on, nor does it convey any information about, activity in the underlying cash market, as would be the case for most traditional hedging activity. Accordingly, the Commission believes the COT reports would be enhanced, and market transparency improved, if commodity index trading were separately reported, provided that such separation can be done accurately.

Following a careful review of all the comments, an analysis of the data generated under the COT reporting system, and a comprehensive series of interviews with traders engaged in commodity index trading, the Commission is taking the following actions. The Commission will continue to publish the four COT reports that it currently publishes— the Futures-Only COT (both long form and short form) and the Futures-and-Options-Combined COT (both long form and short form). Consistent with the comments regarding maintaining the continuity of historical data, there will be no changes in the form, format, or timing of those four reports.

In addition, the Commission will begin publishing a supplemental COT report that includes, in a separate category, the positions of commodity index traders in certain physical commodity futures markets. These so-called "Index Traders" will be drawn from both the current Noncommercial and the Commercial categories. Coming from the Noncommercial category will be managed funds, pension funds and other institutional investors that generally seek exposure to commodity prices as an asset class in an unleveraged and passively-managed[12] manner using a standardized commodity index. Coming from the Commercial category will be entities whose positions predominantly reflect hedging of OTC transactions involving commodity indices—for example, swap dealers holding long futures positions to hedge short OTC commodity index

[12] A passively managed position generally means futures or futures equivalent positions that track a broadly diversified index of physical commodities, which index is calculated, adjusted and re-weighted pursuant to an objective, predetermined mathematical formula, the application of which allows only limited discretion with respect to trading decisions.

exposure opposite institutional traders such as pension funds. These latter position holders are those traders described in the request for comments as "non-traditional commercials." (Note that the four current reports will continue to carry commodity index traders in the same Commercial and Noncommercial categories in which they now appear.)

The Commission believes that a new "COT—Supplemental" report, which separately reports "Index Trading," will better represent its original intent in publishing the COT data with respect to the Commercial and Noncommercial categories, namely, that they show the positions of traders engaged in hedging cash market activities (Commercials) and traders who are speculating (Noncommercials). Traders in the new category of Index Traders will mostly be those that are seeking a more general exposure to commodity prices, typically in a long-only, unleveraged, and passively-managed manner using a standardized commodity index. Traders in the first two categories may be very responsive to price movements and changing market dynamics. Traders in the third category are generally much less responsive to price movements and market fundamentals.

Commission staff spent considerable effort to achieve its purpose of creating an accurate "Index Traders" category. The data in the CFTC large-trader reporting system, which was designed to separate reportable traders only into two broad categories of Commercial and Noncommercial traders, needed to be modified to create, as accurately as possible, a third category of "Index Traders." To accomplish this, the Commission's Market Surveillance economists have: (1) analyzed the futures positions of hundreds of reportable traders in physical commodity futures to determine patterns consistent with index trading; (2) reviewed information from traders' CFTC Forms 40, in which a trader broadly describes his/her uses of futures markets; and (3) conducted over 30 confidential interviews with traders that were known to be, or appeared to be, involved in index trading. Commission staff, having weighed all the available information, has used its best judgment to designate certain traders as Index Traders.[13] Some traders assigned to this category are engaged in other futures activity that could not be disaggregated.[14] As a result, the Index Traders category, which is typically made up of traders with long-only futures positions, will include some short futures positions where traders have multi-dimensional trading activities, the preponderance of which is index trading.

The new supplemental report will be restricted to selected commodity futures markets that are included in commodity indices. The Commission believes that these are the markets where the advent of commodity index trading has raised questions as to whether the current classification of traders into noncommercials and commercials has become inadequate and misleading. No such concern has been expressed about financial futures markets or the many commodity futures markets that are not included in commodity indices.

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[13] These designations have operationally been made by internally assigning an Index Trader code to these traders within the Commission's large-trader reporting system. This assignment as an Index Trader did not change a trader's original classification as either a Commercial or Noncommercial trader.

[14] This issue is not unique to the Index Trader category. For example, the Commercial category includes traders who are engaged in business activities hedged by use of futures or options markets. However, these traders may also use futures markets for other reasons, including for speculation.

At this time, the new report will be limited to agricultural futures markets and, therefore, it will not include energy and metals futures markets. This determination is based on an evaluation of the large-trader data available to the Commission, and in particular on an assessment of the accuracy with which this data can be parsed out, for firms engaged in commodity index trading, between such index trading and other unrelated trading activity. For reasons that are described in more detail below, this issue does not present a significant problem for classification of positions in agricultural futures markets, but presents a substantial obstacle to accurate reporting of commodity index trading in energy and metals futures markets.

The two sources of the difference between agricultural futures markets on the one hand, and energy and metals markets on the other, are the degree to which firms engage in multiple trading activities that fall into different classifications and the degree to which firms engage in internal netting of these activities. This may be illustrated by looking specifically at swap dealers—the most significant component of the new Commodity Index Trading category. A careful review of swap dealer positions shows that, with respect to agricultural commodities, swap dealers' OTC trading activities are generally limited to taking short OTC positions opposite pension funds or other index-based traders seeking to diversify portfolios by adding long commodities exposure. Thus, the swap dealers' futures positions are generally limited to long futures hedges offsetting their short OTC exposure to those pension funds or other index-based traders. Therefore, by separating out the swap dealers' predominantly long futures positions from the Commercial category, the new reports will provide users of the COT reports with a more accurate picture of the use of agricultural futures markets by traders that are engaged in commercial activity in the underlying agricultural cash markets.

In the case of energy and metals markets, however, there are alternative U.S. and non-U.S. exchanges and a multitude of OTC markets and derivative products. Many swap dealers, in addition to their commodity index-related OTC activity, enter into other OTC derivative transactions in individual commodities, both with commercial firms hedging price risk and with speculators taking on price risk. In addition, some swap dealers are very actively engaged in commercial activity in the underlying cash market, such as a physical merchandising or dealing activity. As a result of these other activities, the overall futures positions held by these energy and metals traders in Commission-regulated markets do not necessarily correspond closely with their hedging of OTC commodity index transactions. Indeed, placing the futures positions of such swap dealers in a commodity index trader category would not accurately reflect commodity index trading activity for energy and metals markets. Such a placement would also remove from the Commercial category activity that is predominantly hedging of physical commercial activity. This issue cannot be solved simply by separately reporting futures positions of swap dealers by commercial activity, because much of the underlying activity at these firms is spread among other exchange-traded and OTC markets and is internally netted, with only the residual amount resulting in positions being taken in the futures market.[15] It would be difficult, if not impossible, to link these residual futures positions with any particular part of the underlying activity that

[15] For example, some large swap dealers may assume long OTC positions opposite oil producers or metals refiners who are seeking to hedge anticipated physical production. The long exposure to these traditional hedgers is offset internally against the short exposure to pension funds and other index-based traders and only the swap dealer's net exposure is hedged in the futures market. As a result, the energy and metals positions of these swap dealers may be evenly balanced or even net short.

makes up the "book" of the swap dealer. The Commission has concluded, therefore, that, at present, including the energy and metal markets in the COT—Supplemental report would seriously mislead the public as to the actual amount of index trading and the amount of commercial trading that was present in those markets.

The Commission understands the strong sentiment that it would be desirable to publish the new report for all futures markets that are part of commodity indices. However, for the reasons previously discussed, the Commission is concerned that publishing this data for energy and metals markets, at this time, would be potentially misleading and would not enhance market transparency. Further, the Commission does not want to delay publication of the new report for markets for which it will enhance market transparency, while it continues to study whether it is feasible to publish meaningful reports for other markets. The Commission, therefore, has decided to proceed with publishing the COT—Supplemental report for the following 12 agricultural commodity futures and options on the following exchanges: corn, soybeans, wheat, and soybean oil on the CBOT; wheat on the KCBOT; cotton no. 2, coffee C, sugar no. 11, and cocoa on the New York Board of Trade; and live cattle, lean hogs, and feeder cattle on the CME. The Commission staff is confident that the new classifications of traders for the COT—Supplemental report for these 12 markets is as accurate as the Commission's large-trader reporting system allows.

These 12 markets are substantial in terms of the size of index-trading positions and the numbers of index traders. (The next largest agricultural market in terms of the size of index-trading positions and numbers of index traders is far smaller than any of the 12 selected markets.) Further, each of the these 12 markets has had well over 10 index traders at all times over at least the past 12 months, so that releasing this data in aggregate form should not compromise the confidentiality of the positions of any given trader.

The first of these supplemental reports will be published on January 5, 2007, and will include the positions of traders as of January 2, 2007. Contemporaneously with publication of the first new report, the Commission will also publish comparable weekly data for 2006 for the 12 markets covered by the report in order to allow users of the report to view the new data in context. Thereafter, the new COT—Supplemental report will be published on the same weekly schedule as the existing COT reports. The COT—Supplemental report will be patterned after the current COT short-format report and will be published as a futures-and-options-combined report. The futures-and-options combined report is the most comprehensive of the current COT reports; it shows whether options trading has reduced net exposure as a result of spread trading between futures and options or whether it has added to the futures-only exposure. The Commission believes that the COT—Supplemental report will be most useful as an enhancement to the most comprehensive current report.

The new COT—Supplemental report will be published on a two-year, pilot program basis. During the course of the pilot program, the Commission will assess the relevance and usefulness of the new data and study whether it is possible and appropriate to expand the COT—Supplemental report to include data for other physical commodity markets.