UNITED STATES OF AMERICA

COMMODITY FUTURES TRADING COMMISSION

ROUNDTABLE ON POSITION LIMITS

Washington, D.C.

Thursday, June 19, 2014

PARTICIPANTS:

Panel I: Hedges of a Physical Commodity: Gross Hedging, Cross-Community Hedging, Anticipatory Hedging

TIM BARRY, ICE

LAEL CAMPBELL, Edison Electric Institute

MATTHEW JANSEN, ADM, CMC

THOMAS LaSALA, CME

JOSEPH NICOSIA, Louis Dreyfus

RON OPPENHEIMER, Vitol, CEWG

JOHN PARSONS, MIT

DAVID PEARLMAN, COPE

EDWARD PROSSER, Gavilon, NGFA

KRISTIN REBERTUS, CHS Hedging, NCFC

MIKE RICKS, Cargill

Panel II: Process for Non-Enumerated Exemption:

TIM BARRY, ICE

LAEL CAMPBELL, Edison Electric Institute

MATTHEW JANSEN, ADM, CMC

THOMAS LaSALA, CME

JOSEPH NICOSIA, Louis Dreyfus

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PARTICIPANTS (CONT'D):

JOHN PARSONS, MIT

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Panel III: Spot-Month Limits and Conditional Exemption:

LAYNE CARLSON, MGEX

SEAN COTA, Commodity Markets Oversight Coalition

TERRY DUFFY, CME

EDWARD GALLAGHER, DFA, NCFC

BENJAMIN JACKSON,

JERRY JESKE, Mercuria

EDWARD PROSSER, Gavilon, NGFA

SARAH TOMALTY, BG Group, Natural Gas Supply Association

Panel IV: Aggregation of Positions:

CHARLES CERRIA Hess, CMC

THOMAS LaSALA, CME

WILLIAM McCOY, Morgan Stanley, FIA

MATTHEW NEVINS, SIFMA AMG

PARTICIPANTS (CONT'D):

JOHN PARSONS, MIT

KENNETH RAISLER, Sullivan & Cromwell, PEGCC

MICHAEL SWEENEY, American Gas Association, CEWG

KURT WINDELER, ICE

Other Participants:

TIMOTHY MASSAD

SHARON BOWEN

SCOTT O'MALIA

MARK WETJEN

CHRIS GIANCARLO

KEN DANGER

VINCENT McGONAGLE

RIVA ADRIANCE

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P R O C E E D I N G S

(9:32 a.m.)

MR. McGONAGLE: Good morning, everyone. Welcome to the Staff Roundtable, hosted by the Division of Market Oversight, to discuss position limits. At this time I'd like to turn it over to the Chairman.

CHAIRMAN MASSAD: Good morning. I just want to welcome everybody. I'll turn it back over to Vince, in terms of how the meeting will work. As you know this is a Staff Roundtable, this is not a Commission Meeting.

However, it's quite an auspicious occasion, in that we now have a Commission that is back to full strength of all five members. And moreover all five members are in one room, which has not happened for more than a year, so I know we are all delighted to be here, I certainly am. As a new Chairman I know my fellow new Commissioners, Commissioner Giancarlo, and Commissioner Bowen, are very happy. It took us a little longer to get here than we'd all hoped, but now we are back to full strength.

We look forward to today's Roundtable. We are not going to really make any substantive comments, so that we can get right into the questions of the staff, and I look forward to meeting as many of you as I can. And I know my fellow Commissioners feel the same way. So, back to you, Vince. Thank you.

MR. McGONAGLE: Thank you, Chairman. And welcome Commissioners. My introduction, so I'm Vincent McGonagle, Director of the Division of Market Oversight. Thank you all for coming here today. We have a number of substantive Panel discussions, concerning comments that we've received both to the position limits and the Aggregation proposed Rule Makings.

This is a Staff Roundtable, and it's not a meeting being conducted under the Sunshine Act, as the Chairman referenced. The Commissioners may, of course, ask questions and also request clarifications on points discussed here today. However, when present, Commissioners do not plan to engage in the joint conduct or disposition of official Agency business, and will not deliberate between or among themselves on the topics or issues discussed in today's Roundtable.

Staff have provided questions to the panelists in anticipation of today's meeting. We've also posted those questions onto the CFTC website. Yesterday evening we made some revisions to the questions for Panel 3, so I'll just draw you attention to the fact that the questions on the website have been changed.

The comment period for both the position limits and the aggregation proposed rule makings have been reopened. The current reopened comment period will continue to July 3. In addition, a video -- a video no less -- of this Roundtable will be posted and available shortly.

We welcome comments from the public during the reopened public comment period for both position limits and the aggregation proposal. Comments on the discussion today can be submitted to the Commission during the reopened comment period.

Joining me today; on my right, Riva Spear Adriance; and on my left, Ken Danger, from the Division of Market Oversight. Any views of the staff here represent our own views and do not necessarily represent those of the Division or the Commission. I'll note that our job here today is to listen. We are very close now to getting started.

We have four sessions. I welcome the first Panel to the table. Logistically, I'll ask that when you speak, please press the button to talk, briefly introduce yourself, and the organization you represent. In addition, please turn off your microphone after you speak, as only a limited number may be on at one time. Please also keep cell phones away from the microphone, and we ask that for comments and questions if the panelists can place their name card on its end, so we'll know to recognize you. I'll appreciate that.

So if we can start just with a brief

introduction of the panelists, and I'll start with Ron, over here on my left.

MR. OPPENHEIMER: Good morning. I'm Ron Oppenheimer, I'm General Counsel of Vitol Inc. but I'm here on behalf of Commercial Energy Working Group.

MR. PARSONS: Good morning. I'm John Parsons, I teach Corporate Finance at MIT Sloan School.

MR. PROSSER: Good morning. I'm Ed Prosser. I am the VP of Agriculture Trading for Gavilon, and I'm here to represent Gavilon and the National Grain and Feed Association.

MS. ROBERTUS: Good morning. I'm Kris Robertus, I represent CHS Inc., and I'm the Director of Enterprise Risk Management.

MR. RICKS: Good morning. I'm Michael Ricks, with Cargill.

MR. JANSEN: Good morning. I'm Matt Jansen. I'm Chief Risk officer of ADM. I also serve as the President of our Global Oilseeds Business. And I'm also here representing

Commodity Markets Council as Vice Chairman.

MR. CAMPBELL: Good morning. I'm Lael Campbell, Director of Regulatory Affairs for Exelon Constellation, a fully integrated energy company; I'm here on behalf of the Edison Electric Institute, which is the association for all of the investor owned utilities in the United States, and EEI Members are responsible for serving electricity to more than 70 percent of the U.S. Population.

MR. PEARLMAN: Good morning. My name is David Pearlman. I'm from the law firm of Bracewell & Giuliani. We represent the Coalition of Physical Energy Companies, as well as a number of other similarly-situated physical companies. Our clients are the hedgers, as well as other people here represent hedgers, but we are hedgers in a physical energy space.

MR. NICOSIA: Good morning. I'm Joe Nicosia. I'm Global Platform Head, and Senior Vice President with Louis Dreyfus Commodities.

MR. BARRY: Good morning. I'm Tim Barry

with ICE Futures U.S.

MR. LaSALA: Good morning. I am Tom LaSala. I am the Chief Regulatory Officer for the CME Group.

MR. McGONAGLE: Great. Thank you. So during this first Panel, we are going to focus on hedges for physical commodities, gross hedging, cross commodity hedging and anticipatory hedging. We have a number of questions that we had set forth in the document, but before we start, sort of digging though, into those, on a one-by-one basis, I'd like to turn it over to Ron, to give us sort of an overview perspective from the commenters on bona fide hedging. Ron?

MR. OPPENHEIMER: Thank you very much, Vincent. And thanks to the Commission for holding this Roundtable. In particular I want to thank Chairman Massad and Commissioner Bowen and Commissioner Giancarlo for making time. I know you're probably drinking from the fire hose right now, and so we really appreciate your making time for us.

This is a very important rulemaking to us. The Commercial Energy Working Group is comprised of firms from all aspects of the energy business, oil, gas and power, upstream, midstream and downstream, integrated companies, and independent companies. And as substantial users of the markets, we support the Commission's mandate that pricing be established by forces of supply and demand, and not by extraneous outside forces.

We understand, and I think part of the reason why we are still having debates on some of these issues, is the Commission's concern for some loopholes that could undermine the ability to limit speculative trading and that would allow speculative trading under the name of hedging.

Our concern is on the other side of that, and that is that legitimate hedging activities might be sacrificed in order to prevent any abuse that might occur in the marketplace. We think it's very important to keep focused on the public policy drivers behind speculative position limit rules.

The speculative position limit rules have always existed for one particular purpose, and that's to prevent the harm that could be caused by excessive speculation. And Dodd-Frank really didn't change that. Dodd-Frank had speculative position limit provisions in it mainly to accomplish two goals. First of all, to include swaps within the speculative position limit regime. And secondly, to address concerns that had arisen with respect to what I'll call investor money, principally on the long side, and what effect that might have on pricing.

The Dodd-Frank Provisions really weren't addressed at perceived abuses with respect to commercial hedging. In fact, really the opposite; in Dodd-Frank Congress gave the Commission exemptive authority, so that any legitimate end user hedging activity that wasn't foreseen at the time could be exempted by the Commission, as it saw fit. And the public interest also supports commercial hedging, because at the end of the day effective hedging programs reduce the ultimate price of energy commodities, and all commodities to consumers.

We are very committed to working with the Commission to address all of these issues we have for the last, unfortunately, several years I will say; we are interested in closing the loopholes, we are interested in preserving the markets for legitimate commercial end-user hedging. And personally, I would like to say, we are committed to try to put this behind us and focus on other things.

The Working Group has written extensive comments, and I know that you've got them -- you've probably read them, if not, I know that you will read in the near future, and I'm not going to address everything in the comment letter but, as Vince said, I'd like to sort of lay out some of the landscape of the different issues that we see out there. And it may seem like a long list, but it's really not, I think we are in striking distance with some good, constructive dialogue to closing the gaps on some of these issues.

Two of them are new in the proposed rule that didn't exist in some of the other speculative position limit rules that we've seen in the past. The first one is the construct of what's called the economically appropriate test. It's always been the case that the Statute and the Regs said that a hedge had to be economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise in order to be bona fide.

But in the proposal, for the first time, the Commission has written that the measurement of that, is that it has to reduce the risk to the entire enterprise. In other words, that risk has to be managed on a global affiliated entity basis, and that's not how risk is managed in the energy space. Different companies do it differently. Some do it on the enterprise basis, some do it on a corporate or division-wide basis, some do it by trading desk or trader, and some do it on a strategy level. And many do it on a combination of all of those things. The Rule wouldn't permit that.

We think that's a problem and we think that needs to be addressed so that companies can manage their risks in the prudent ways they see appropriate to do it. In the cross commodity -- cross commodity hedging space there's a new quantitative test that never existed before. Essentially there's a Safe Harbor for cross commodity correlations that exceed a particular mathematical number.

That formula, and we've put some examples in our comment letter, would exclude from bona fide hedge treatment, things that we commonly use as cross hedging, the most obvious being natural gas to hedge power prices, but in the oil space blend stocks which become gasoline, or become RBOB, which is the deliverable greater under the NYMEX Contract, some of the blend stocks also would not qualify for cross commodity treatment, and we think that's a problem.

Some of the older issues that have been

out there but, you know, remain a problem, are the so-called Five-Day Rule. So-called Five-Day Rule by itself, in its simplest form is not that big a problem, it suggests that you can't hold a commodity for certain types of hedges into the last few days of trading in the contract, if you don't have the ability to make or take delivery of that commodity. It works in some cases, in others it doesn't.

When the Commission first passed that Rule in 1977, the only commodities it had speculative position limits for were agricultural commodities, and it specifically said, at sometime in the future when we consider other commodities, we will consider changing the Five-Day Rule. That's particularly appropriate at this point in time. Very simply deliverable supply is the baseline for which the Commission will establish spot-month position limits, the CME has submitted updated data for what constitutes deliverable supply in energy contracts.

We would recommend that the Commission

adopt those numbers of deliverable supply for the purpose of setting spot-month limits. The single and all-month limits for the RBOB and the heating oil futures contracts, quite simply are too low. The Commission's data, it's in Table 11 of the Proposed Rule, supports the fact that they are too low, it identifies between 7 and 11 companies whose positions would have exceeded the limits if they were in place as they are proposed to be set, and taking those companies out of the market would draw substantial liquidity away from the markets particularly in the out months where liquidity is limited to begin with.

Trade options and volumetric options are really physical delivery contracts, and not hedging instruments or speculative instruments and should be removed from the speculative position limit rules, and we would support a process whereby the Commission could look at non-enumerated hedges on an expedited basis.

The biggest issue to us is of course merchandizing and anticipatory merchandising hedging. The Working Group has put a number of examples in its comment letters, many of them were the subject of a petition filed with respect to the now Vacated Rule. I'm not going to go into detail of any of them right now, but would be delighted to either as part of this discussion or later, to explain exactly why they are risk-reducing and not speculative positions.

It's a little surprising that the subject has become as controversial as it has. The starting point for considering whether or not merchandising hedges and anticipatory merchandising hedges should be permitted is really the statute, and it's very clear that the statute provides for those types of hedging activity. There's no distinction in the statute between that kind of activity and anticipatory hedging by producers and processors, and there's no -- we think the problem may stem from a fundamental misunderstanding of the merchandising function.

Merchandizes move commodities from one location to another where prices dictate they should go, where supplies in lesser supply in one region and greater demand in the region, prices dictated that it should move. And the merchandisers connect the producer to the consumer, merchandisers actually own the commodity. They store the commodity, they blend the commodity, and they deliver them to users so that the users can demand them on an as-needed basis, freeing up their own credit and their capital for other uses.

Merchandisers buy commodities in regions where users can't, or decide not to go and have commercial relationships. Merchandisers allow producers and users to outsource all the logistics and risks of arranging transportation and scheduling, managing customs, inspections and all the other operations that go along with the physical energy business. Merchandisers have as much invested in their business as producers and processors, it's their credit and capital that support the purchases, sales and the inventory they carry.

They own and they charter vessels and barges, they own or lease, storage and pipeline capacity, and transmission. They invest in technology systems and personnel that make it all work. In short, merchandising should never be confused with paper trading. We don't see the logic in permitting anticipatory hedging for producers and processors while prohibiting it for merchandisers.

Just as a very quick example, a merchandiser who buys product at a floating price with the intention of moving it somewhere else, and selling it at a floating price, needs to lock in the differential between those two prices in order to justify making the purchase in the first place, and engaging in the merchandising activity that brings the commodity to the consumer where the consumer needs it.

It's really no different than the producer who has oil in the ground that he has not yet produced, and has not yet sold. He has an unfixed price risk which he wants to hedge with an anticipatory unsold production hedge. It's the same thing as the processor who hasn't yet filled his requirements. If the merchant has brought -- I'm sorry -- has sold before he has bought, he has the same risk that the processor has when he is trying to hedge his unfilled anticipated requirements.

Just in closing, I want to say that the concern about speculation slipping through a door open for hedging, has some serious criteria that will limit those possibilities that are already in place, and I know you know of all of them, so I'll go very quickly. But some of them go to the staff's questions. The ordinary course documents maintained by a physical energy company will go a long way toward defeating any possibility that the hedging exemption is abused.

The company's hedging strategy is in its documents, and whether it's conducted in an affiliate- wide basis or something else, that's also contained in the records. Whether they've made a binding bidder offer and how they've hedged it, that's in their records. What financial commitments they've made to an anticipated transaction, such as establishing one leg of a two-legged transaction, that's in their records. And all of the transaction records that support a bona fide hedge exemption are required to be kept under CFTC Rules, and made available for inspection and responsive to special calls.

DCM oversight will remain in place. In my opinion it's the most effective tool to ensure against abuse, and I think Tom will probably cover that more as we go forward. Positions that are in excess of spec limits pursuant to hedge exemptions, have to be reported on a Form 204 and explained. And that's done under the penalty of perjury, and so I think that goes a long way to ensuring that there won't be false statements about hedging activity.

Then finally there's anti-disruptive trading practice requirements, there are orderly trading requirements and there are anti-manipulation rules. So if anybody took a position in claiming a hedge exemption, and did anything that disrupted the markets there's ample opportunity to challenge that activity.

In closing I just want to say thank you again. We are very grateful for all the time that the Commission and the Staff has given us over the years as we've debated position limits. We are very hopeful that we can continue to do that, and we are hopeful we can be a resource to the Commission as we move forward. Thanks, Vince, and I'm happy to move to questions.

MR. McGONAGLE: Thanks, Ron. I think that's a very good overview of the session for this morning. I want to go into some detail with respect to the application of these particular hedges. Thinking about some of the themes that we articulated in the questions, which are focusing first on what the statute discusses on the economic appropriate test, which is the reduction of risk in the conduct and management of a commercial enterprise.

How are these risks then, separately

being managed, separate from a request for a bona fide hedge exemption? How does the firm manage its own risk profile? And how is the request for the exemption consistent with that profile? And what assistance can you give us, the staff, on evaluating the difference between what is being put forth as a bona fide hedge exemption request, versus speculation. And then, you know, how do we document them. I know Ron has touched on a number of these in particular examples.

Looking at gross hedging then, for example, I know in our -- the Notice of Proposed Rulemaking, we were focused on -- you know, if you drill down to identify specific risks, we've put forth that the staff would be in agreement that so long as -- you didn't need to require that there be netting, but that if you had, you know, multiple identified specific risks, if you hedged each of those, that might be sufficient for an exemption. The question I think that we see is, is there a selective use of a specific identified risk for a hedge exemption that, effectively, doesn't result in the netting of risk at the entity level?

And so how do we differentiate with respect to gross hedging a bona fide exemption versus speculation? And I think the same analysis might apply to the difference of the operating units. So I put that out to the Panel, if you want to talk in a little more detail about how we can evaluate gross hedging in way that would recognize a bona fide hedge exemption.

MR. PEARLMAN: I'm going to answer that question but I want to make a statement first -- this is Dave Pearlman -- that I agree with really, everything Ron said, but I would ask that the Commission think about, in the context of this issue, potentially taking a step back, because I don't want the conversation to start out with the concept that the only way to deal with issues of position limits, and dealing with the concern about excessive speculation, is to create a regime of enumerated hedges, and complex record keeping, and difficult reporting arrangements.

Because the thing I want to say, I agree, again, with what Ron said, but stepping back from that, my clients are a group of physical energy companies that are historically users of the exchanges and they are familiar with the manner in which exchange position limits work, and they have over- the-counter swaps, historically. And in doing so they manage their risk -- and I'll get to your question in a minute -- but in doing so they understand what they need to do if they need a hedge exemption, which is to come to the Exchange because they are not in the enumerated hedge world, and basically explain what their risks are, show their physical business, and then through the exchanges well- equipped staff who are expert in this, there is a manner in which the, a hedge exemption can be provided to an entity that needs one. And I'm sure that Tom can talk about that in more detail.

But for my clients, we are switching from that regime, which is one in which they can talk about their business. Talk about what their risks are. Provide sufficient information to get a hedge exemption which caps their position, to one in which every time they do a trade they have to figure out which enumerated hedge it is, the trader has to know that, it needs to be identified, it needs to go into the records.

If they are dealing with a swap dealer they are going need to make binding reps that this can be a pass- through hedge, and do a number of very complicated, and actually confusing, activities to completely change the regime they're living within. The other thing they are going to have to do, is track swaps in this regard. And, again, one thing we'd like you to think about is that swaps that are OTC swaps, and as Ron said, trade options. These are not price discovery vehicles, we understand the need in a price discovery world to be concerned about excessive speculation, but we ask you to think about whether there's a price discovery impact of excessive speculation, in non- transparent OTC swaps; and certainly, in physical delivery trade options.

So we would like you, for our segment of the market, which is hedgers-- who have historically been on exchanges and have been able to have non-enumerated relationships where we would get hedge exemptions, as well as engage in over-the-counter swaps--to maybe think about ways to make this less burdensome, because this is the most burdensome element of Dodd-Frank to non-registrants. And to turn around and implement this at organizations that are not well resourced to make this an entire effort. When we were about to do it last time it was incredibly burdensome.

So with that I'll answer your question, I'll be happy to talk more about this threshold issue.

MR. McGONAGLE: What do we want to see? Is there any reaction on the Panel, agreement or comment on those remarks?

MR. PEARLMAN: I guess we are the Lone Ranger on this. But I do think, frankly, if you were to reach out to market participants who are not at a sophisticated level of doing significant amounts of merchandising, trading, that sort of thing, that we are more, I would call them garden variety hedgers. You'll find that what I'm telling you is very much a concern that they have. And again you have, I think, a little more of a higher level of sophistication around this table, and frankly if you were to think about the numbers that this Rule affects of just individual organizations, probably the bulk of those organizations are in the category that I'm describing and we can talk about it offline, or we can bring those people to meet with you if you like then -- though the folks who do larger and more sophisticated business.

So let me come back to your question and I think it follows along what Ron was saying. When companies such as the companies that I represent do their hedging, and think about how they are hedging their risks. They start out with a structure where, typically from a management perspective they have no interest in, and frankly, they are prohibited from speculating. So the organization has a structure in which speculation is not permissible.

That is typically the case; there may be some very minor speculative activity that could be permitted to engage in price discovery or some sort of non-business line activity, it's really not the purpose of it, but the purpose of touching these markets is to hedge, so you start out by looking at the basic mission that the individuals touching these markets have, which is to hedge.

There is also oftentimes, if you have loan documents or project finance arrangements around these types of businesses, the lenders will have covenants, required covenants, that there will be no hedging -- I mean no speculation, pardon me, and there will be likely a mandate for some level of hedging. And that's what we see in our business. So we have documentation that at the threshold, before you go into the market, you are precluded from speculating, or if there's some kind of tiny tranche you can, or your lender precludes you from speculating, requires you to hedge.

And as Ron said, then what follows from that, is an effort to execute the mandate that's been provided by management, and in doing so, this whole idea of gross or net, or whatever, across the enterprise, is really not contemplated in the kind of quantitative techniques that you're talking about, or how to actually capture this for you to then come back with what I assume you're talking about, is the enumerated hedge of some sort.

It's really a business-related process that is endeavoring to accomplish the hedging mission of the business, and you'll see an entire sort of dialogue between management and the business to identify how they are hedging, to accomplish hedging, to report that they've implemented a hedge plan, to have periodic reports on how the hedges are performing, all that sort of thing. And I think if you were to look, to understand gross, net, whatever, because that's not the way that it's thought of.

Whether there was hedging taking place, you would find a significant documentary basis for it, and frankly I think people would have personnel action taken against them if they want to speculate in this business segment, because frankly that's a great way to lose money, and these people are not in that business, and their investors don't want them speculating.

So the bottom line of what I'm saying is, that the way you are looking at it, is not the way these businesses look at it. If there's something you'd like them to do to demonstrate that they are hedging in some technique that would be satisfactory to you, to demonstrate that, that could be done, but it's a back fit on everything that's done today. And frankly the whole enumerated hedging process is a back fit on what people do today. It is not the way that firms think about their activities when they hedge.

MR. McGONAGLE: Thanks, David. Joe?

MR. NICOSIA: Thank you. In response to your question, I'm going to go a little bit around it, but get to it. When we look at gross or net hedging, the ability to take it in totally on a global basis, or an entire universe is almost impossible. I think it's important for the Commission to understand and recognize that we have many risks that we manage and hedge within our own businesses. And these risks are more than just flat price or absolute price risk.

These risks that we have, if you take a narrow and a restrictive view of the interpretation of hedging, it can be very detrimental to our business. Some of these risks will include time risk, we have location risk, quality risk, quantity risk, credit risk, execution risk, counterparty risk, governmental or sovereign risk, just to name a few of these things. And we need the marketplaces in order to hedge these in very different ways. Probably the most important thing is that you need to recognize that price risk is not just absolute, but it's also relative price risk. It seems that that has been lost somewhere along the way.

When we say relative price risk, we are talking about the ability to have ownership, and then have an off- setting, what is known as a hedge, against it. The most common form of this is to use futures, and what is known as basis trading. But basis trading in and of itself is a risk, is a shift of risk from absolute to relative. It is one that requires usually the use of the futures market, and then also requires us to be able to use future futures spreads and the cash market.

Along this line, and taking care of this risk one of the most important things is convergence. The need for convergence in the marketplace, and convergence takes place, not just by a user or a producer, but more importantly also the inclusion of the merchandiser. It is their inclusion in these markets that allows and calls for the convergence within the futures market. In order to have that, the hedger, the merchandiser has to be able to be allowed to use the marketplace, and have access to it.

Without it, risk premiums are going to rise throughout our business, and when the risk premium rises, it's going to move throughout the supply chain, and that will raise the cost of doing business. And the end result of that is that the producers will receive less for their product. Consumers are going to pay more for their product, because someone has to absorb that risk cost that's going to take place.

Bid/offer spreads are going to widen, liquidity is going to dry up, and ultimately, less business is going to be done here. So when we look at that there's really three main issues that we need to really address here. One is the inclusion of merchandising into the exemption. It is not understandable how that could be removed. The merchant accepts far more risks than anyone else in the value chain. He has to absorb all of those risks that I mentioned before.

The second area is anticipatory. The anticipatory hedging needs, there is almost nothing that takes place in this business that doesn't have some form of anticipation in it. Whether it is -- whether you will make a sale, whether your quality will be right, whether the quantity will arrive on time, what time the boat arrives, what are your export commitments, whatever the case may be. Not to mention simple things such as weather.

And the third thing is your treatment of fixed and unfixed sales with your inability to recognize unfixed sales as that which you need, that the merchandiser has, for treatment in the hedging. Now, to return to the question about a universal versus gross, versus net; because we have so many different needs to be hedged, not just absolute flat price risk, you will find that different entities, whether they be assets, whether they be countries, whether they be products, whether they be cross products, have different means and times for those risks that they need to hedge. The fact that you may be long soya beans universally, does you no good if you have a crushing plant in area that has had a drought or is short in supply. You will not be able to move those beans from South America on a timely basis into your plant in Indiana.

And conversely, the same thing that can take place of whether you were working on shipping lines, transportation, logistics, whatever it is. So no matter what you do, even if you try to look at it on a global basis you will have to manage your risk on an entity, but more importantly, on a need basis, because those needs will arrive from both geographical different needs, from the ability to have to deal with supply, from the ability you have to deal with execution, and therefore it's universally impossible to do it on a gross scale -- I mean totally universal basis.

MR. McGONAGLE: Thanks, Joe. Lael?

MR. CAMPBELL: Yeah. I want to comment on this gross versus net issue, because it's very important to the electricity industry, which, it's very regional in nature, electricity prices can vary, depending on the unique attributes of different parts of the country, supply, load, fuel type requirements can all make electricity prices very different, dependent on the region you are in.

Most risks in the electricity industry is not managed on an entity level, certainly not managed on an enterprise level, it's managed on a regional level. We have traders that are responsible for a portfolio of positions, either customer demand, which we call "load" in the electricity industry, or generation, and they are responsible for managing the risk in their particular region.

You know, we could be -- have less, much less generation than we do customers to serve in Texas, where prices are trading around $150, and we could have much more generation in the Northeast than we do have customer served, so we are long generation Northeast where the cost is around $60. Those positions are not natural offsets to each other. They need to be managed independently, and forcing us to net these types of positions is going to cause problems.

Even within the same region, I could have a gas generator, still in the ground, and managing the risk of that generator, I have fuel requirements that I have to manage. I may also have gas storage facility in that same region, but I may need to manage that gas storage facility, separately from that generator, even it's in the same region; because I don't necessarily have the transmission to get the gas out of the storage to that particular generator.

So it's very important, and I want to echo what David said, what Ron said at the outset, and what Joe just said, you know, accepted risk management practices of the industry that have been around for a long time, need to be maintained. There is a lot of distrust in the rules, and as Ron pointed out in the outset, there is no evidence of anyone abusing the bona fide hedge rules to engage in speculative activities.

And in an attempt to catch a theoretical bad actor, you are potentially impacting real, legitimate hedgers that have serious risks to manage in their day-to- day business operations. And one of the points I want to make is that in a -- Joe talked about this too, and so did David-- is that there are built-in controls within each of our companies. These are important risks for us to manage. We have an army of people that are, everyday, assessing our physical risk exposures, and our hedges against those exposures.

If the hedge gets out of whack, it's out of correlation that's costing us money, and we are going to have to do something about it to adjust the hedge, or put on a hedge if something is not hedged enough. We have the infrastructure in place. We are managing value at risk, VAR, every single day, and adjusting our hedges accordingly.

So, again, I think the Commission should be very differential to those that are out in the industry every day managing these risks, they have a lot of experience doing it. They have a lot of infrastructure in place to make sure they are doing it right, and I would hope that at the end of the day we could have a rule that's deferential to those practices.

MR. McGONAGLE: Thanks, Lael. We'll go to Matt, and then Tom, and then I want to move to cross-commodity hedging.

MR. JANSEN: Okay. Thank you. And first of all, I agree with everything that's been said from the Panel, so far, this morning. When I think about ADM, for an example, as a hedger and a merchandiser of crops, we have over 400 locations just in the U.S. and many of those are locations that are deliverable, in one form or another. And so we are, as an example, a place where convergence actually happens.

And I think one of the potential consequences that we are facing right now, as Joe pointed out, is a potential lack, or a moving away from convergence, that I don't think is anything that this Committee or the industry supports. And so, you know, as we are buying -- and merchandising--you know, the U.S. crops in these 400 locations, and even more, this ability to -- we manage on as-need basis, the risk, at the location. And then we also aggregate that up from an enterprise standpoint, so there is a component of netting, but it's on an as-need basis. And I believe it's extremely important to be able to maintain that flexibility in order to allow us to do that.

MR. McGONAGLE: Tom, before we go to you, Ken had a comment.

MR. DANGER: I just wanted to tee up a really simple example. Sometimes it's helpful, I know it's very complicated, the situations that you are all facing, but it's sometimes simple to -- good to focus on something simple. So let's tee up this example, this hypothetical. Let's imagine that the -- we have an all months combined --

MR. WETJEN: Maybe you can move your mic up a little it.

MR. DANGER: I'm sorry. We have an all months combined limit the Commission has established, let's imagine that that number is 20 contracts, and let's imagine then a trader has sold forward three months from now at a fixed price 50 contracts worth of this commodity -- I'm sorry -- purchased forward 50 contracts to this commodity at a fixed price, and the in six months' time has sold another 50 contracts at a fixed price. So in that five to six months -- and it's all at the same locations so those 50 contracts presumably could be used to satisfy these sales that are six months out. And so what I'd like you to have a think about, and maybe talk about is, would it be appropriate for that trader to hedge all of its fixed-price sales contract in the nearby contracts? In other words, put on 50 contracts worth of long fixed-price futures and to hedge its fixed-price sales six months out, when the spec limit is indeed 20 contracts. Would that be bona fide hedging or not? Would that be increasing risk to the firm? That's all this trader has on, it's just those simple fixed-price sales and purchases.

MR. McGONAGLE: So I think you've got Ed to bite.

MR. PROSSER: When you think about the way that, in the enumerated Ag space we hedge our book we look every day for the most effective hedge that we can find. That hedge might not be right next to every sale that we have on. But as you look at each one of those individual sales, they aggregate into a larger risk; and you then try to find what is the most effective hedge in -- with location and quantity and quality, and all those other risks other than price that we talked about.

So I think the idea that we segregate each one of our individual transactions and try to hedge that individual transaction, in Matt's case would be tens of thousands of transactions a month and it's impractical. I think that one of the things that the Commission doesn't understand quite well enough is the complexity of this gross hedging concept. A bushel of wheat in Australia and a bushel of wheat in Indiana, and a bushel of wheat in Washington, if you throw it all together, and then hedge it one time, if you've got purchases and sales, it seems simple.

But the fact is that those have -- those cash commodities have unique risks all their own, and they are not equivalent. So forcing us to try to create some equivalency of cash, before we go to the derivative, is really the crux of the problem here when we try to figure out what we are doing on this gross versus net. The reason that we don't all hedge gross is because it doesn't work. It's not an effective hedge. We have to go out and segment. Ukrainian wheat hedged in Chicago has an entirely different risk profile than wheat in the Ohio Valley hedged in Chicago.

And I think that gets to the point where these businesses are very complex, it's much too simple just to make these physical commodities equivalent to the derivative and say that everything that's left you can hedge, but you have to offset first.

MR. DANGER: If I might go back to it. In the very specific hypothetical that I asked about, is that increasing risk to the firm, or decreasing risk?

MR. NICOSIA: Ken, if I could try that. First of all, in the specific question that you asked, almost never exists. Okay, because you have quality risk, you have time risk, you have execution risk, but even as you start to narrow it down to the one/one-hundredth of a percent of what we actually do, that falls into that category, you can have legitimate reasons for that.

For example, it may very well involve an asset, because that transaction that takes place, may take place all within your own elevator, for example, if it were grain. And during that six-month time period that you have, if you were going to be locking up grain, maybe you've bought that exact stuff, and you are going to carry it forward, maybe you have already bought it forward and not carrying it. But if you carry it forward, you have storage income that you want to protect at that point in time.

Yeah. And when you say protect it, because as the market moves the value of what you have changes. So if the Board spreads change over time, the fact that you do or do not have it hedged does not mean that the value of what you have in store does or does not change, because it does.

And, for example, if the market were to invert, and you were out long in store, even though it's against the sale for six months out, it would be to your benefit to sell that grain out immediately, and replace it with another purchase down the road. Conversely, if you went to a very large carry, in the marketplace, it would behoove you to maybe buy additional grain today because you would build on your storage, make more money by carrying to your six-month sale, and actually selling out which you had had originally pegged against that sale for him.

So, these dynamics that take place in the marketplace is how we manage inventory, how we manage risk, and create the opportunity that the markets create, because carries and inverses are creating the ability to alter the flow of the commodity that's there, that's our job to react to it. So, yes, it can definitely be an appropriate hedge in thinking of how we manage our inventory.

MR. McGONAGLE: Tom, you were up from a couple minutes ago. I don't know if we passed you by.

MR. LaSALA: No worries. Thanks, Vince. A quick comment, observation, I guess, on process, because there have been a number of comments around the table what people are used to, exchanged managed exemptions, I just maybe -- just take a moment and just clarify that, clearly at CME Group, we are in the business of managing exemptions, in enumerated market as well as those that are non-enumerated.

And frankly, there are differences between the two. In the enumerated you are bound to enumerated examples as, you know, detailed in the regulations. In the non- enumerated there's broader authority, for example, risk management exemptions, which in today's world where I know some of the comments made around the table would be reflective of things, such as anticipatory merchandising. So it's one of the challenges, I think there are two major challenges here today, and these examples I think are great.

The challenges are, you know, you've got a circumstance that -- most circumstances I deal with -- we deal with is in one -- I'm going to say asset class -- something seems very legitimate, examples of anticipatory merchandising that we feel comfortable and grant exemptions, they seem logical, economically appropriate. You can demonstrate past performance by the participant in terms of sales movements. We can grant that; always sensitive to concentration and the like.

In the enumerated it's not available. The challenge, you know, I guess I would say, it's furthered in this exercise that's a challenge for this Agency, is in the proposal, not only do you have this disparity, but you are in some regards taking away. So I have the -- we have the hard explanation to a company or companies saying on one hand, this makes total sense, we'll do this here, it's the exact same thing in another asset class, and for some reason, it's non-applicable, and then in the proposal, we seemingly do away with some of those.

MS. ADRIANCE: I'd like to just ask a question to follow up, Tom. When you said it's not available in the enumerated, it sounds as if -- and I'm trying to understand if I understood you correctly. Because an enumerated is available, if it's an enumerated exemption it is available. I think what you are saying is that if it -- if this particular trade the trader wants to hedge is not enumerated, that you are referring to fact that what is the process for going through and getting a non-enumerated hedge exempted from -- or to allow it to be used as bona fide hedge. Is that what you're referring to?

MR. LaSALA: No. No. I'm sorry. It wasn't clear. While you could get a non-enumerated exemption by petitioning the commission, in markets such as energy, the ability for us to grant those types of exemptions are within our discretion as the contract market. And entities around the table here will tell you that, well, we've applied for, and I think appropriately, received those exemptions in the energy space, yet, that exemption, broadly speaking, is not simply available because it's not enumerated in, let's say, the agricultural markets.

MS. ADRIANCE: So, just to make sure I'm understanding you correctly. So what you are bringing up is the issue that under the proposal, whether or not you, as an Exchange will be able to grant a particular exemption if somebody comes to you. You are talking about the limitations that might be placed on you -- on your ability to grant an exemption.

MR. LaSALA: It certainly places a limitation on me; it does. And I think it places, you know, I guess, additional challenges on the party requesting that exemption.

MR. McGONAGLE: John?

MR. PARSONS: So I'm going try to

address Ken's question, and I think -- so the specific question you asked about that particular hedge, there's a classic case that addresses that, which is the oil hedge speculation that Metallgesellschaft did back in 1993, there's been a whole raft of literature trying to analyze exactly your question, most of which arrived at that hedging with the front month for that particular one was a speculative venture, and increased the risk of the firm.

I think it's a useful case to look back at to address some of the other points that have been made here. I think it identifies very clearly, that quite often you have companies that look like end users that are speculating. And in particular, back then in '93, when there was much less liquidity in the oil market, they consumed a huge volume of the front month contracts. They moved the price when they rolled that particular strategy, and they had to trade OTC contracts to try to hide the size of their position, and those OTC contracts were relevant for moving the prices.

So I think there's a bigger point here, we have lots of research that demonstrates that there is speculation done by end users, obviously not by all end users, and obviously there's a lot of hedging. I can think of a particular article demonstrating that in the chemicals industry, there's a lot of speculating on interest rates, more recent literature about lots of commodity companies' derivatives positions fluctuating far too much to be counted as hedges for those companies' positions.

You know, when we talk about this gross hedging point, many people have pointed out, I think accurately, that oftentimes companies don't structure their hedges that way because there's geographical-basis risk. But you can see my point about speculation in the same way. There are lots of electricity companies that trade derivatives in regions of the country where they have no physical positions whatsoever. They are running a proprietary trading book in that particular transaction.

So I think it's true that it's very hard to impose this kind of gross hedging criteria, because for a lot of real hedges that's not how it's managed. But I think you have the real problem of how to distinguish some actual speculation that really does go on, from real hedging. And I think there are only two ways to do that. One is measurement, quantification, which companies regularly do do, because they want to measure and show that they are reducing hedge.

There is no other way for senior management to maintain serious control over operations without some kind of quantification. But there's also lots of other business practices that have been discussed here. I think we are repeating a conversation that we had over the Volcker Rule, which successfully focused on what are the actual documentation business practices, compensation practices, and so on.

We can't look at any transaction independently of how it's actually operated in the company, and it seems to me we arrived in that at a very successful resolution, you know, everything remains to be seen; but it was realistic because it looked at what companies actually did and tried to distinguish them. And you can distinguish proprietary speculative trading from hedges, and it happens inside the way companies manage them.

MR. WETJEN: But John, other than measuring or quantifying the risk as you've put it, it sounds like you had something else in mind in addition to that that could be used as a tool.

MR. PARSONS: Well, business practices do it. Most companies that do speculative trading, in the way you see those speculative books managed, are going to be managed differently than the hedge, and most of the time, hedges are going to be managed in concert with the physical positions that they are attempting to hedge, and there will be a number of forensic or fingerprint evidence that that's how the company is managing its operations.

For example, if you are hedging, you are going to be rewarding your traders for reducing risk, whereas if you are doing speculative trading, they are going to be given bonuses for the size of the profit, which is going to be more when it's a large profit. If you are giving them incentives to reduce risks, you are not going to want to see a huge outsized profit on a particular transaction. So that's an example of the business conduct that can distinguish one from the other.

MR. McGONAGLE: Great. We'll turn quickly to cross-commodity hedging, and then I want to move back over to anticipatory merchandising. On cross-commodity hedging, Ron touched on two items in the overview that he gave, but we have a qualitative test, a quantitative test, and there's recommendation or consideration surrounding whether there's an exit from trading of that particularly commodity within the final days of trading.

So, let me put out to the Panel, and there's this general question, of those three items. Sort of what -- where should staff be focusing our time on the comments, where are your biggest concerns?

MR. RICKS: Mike Ricks. I guess when it comes to cross-hedging, I mean, I don't know if you could look at almost any commodity and you're going to find periods where it's a 100 percent positive correlation and 100 percent negative correlation. Just given the time of the year, the events, the environments. You know, so to assign an 80 percent correlation in order for it to be a valid cross hedge, is beyond impossible, simply because these relationships are so dynamic.

So what a merchant is going to do, is you could argue that buying a truckload of corn in the middle of Kansas, which is not deliverable, and hedging it in Chicago, that could be cross heading because it's not deliverable. Or buying, you know, a vessel of corn in the Ukraine, should that be hedged or not? The merchant is going to make the decision, basically, how is that going to -- transaction is going to reduce the risk.

And it may well be that not hedging is the way to do it. It may well be that hedging that truckload of corn in Kansas, that may be best hedged in the wheat pit, because that corn is going to likely compete with wheat for feed, or it may be best hedged in Chicago. So how you define cross hedging in these relationships, like I said, can go from, you know, negative 1.0 to positive 1.0, and the merchant is going to look at his time period, which one is going to reduce the risk.

MR. McGONAGLE: So you're focusing us on -- more on evaluation on the qualitative analysis and moving away from a quantitative review?

MR. RICKS: Yeah, because I believe that's what was mentioned in the rules, and 80 percent correlation, or along those lines, and we are going to look at -- in the window that we are exposed to that risk, which derivative, or not derivative, is the best way to reduce that risk. But what that does too is, it's not just the action of Cargill, or one firm, or ADM, you know, it's the wisdom of all the firms making these decisions. That gets immediately transmitted into prices. These price signals are transparent, the whole market sees them. And that's how people make decisions, that's how we allocate scarce resources.

That tells the farmer what to grow. That tells a feeder, should I take corn out of my ration, increase soya bean meal? That tells the flour miller, should I use more spring wheat, less soft wheat? That's why there's so much interest in this, because we see these signals get efficiently transmitted every day into the role that they provide in allocating scarce resources. And our fear is that with this rulemaking we break that mechanism.

MR. McGONAGLE: So, I'll turn it to Ron. But this is sort of the objective identifying factors to look at -- you know, and what we have is sort of art and science, the qualitative factors, the quantitative factors. So, you know, if we are charged with evaluating why people have sought a particular hedge for cross-commodity, how are we able to do that across industry or across platforms. Ron?

MR. OPPENHEIMER: Yeah. Thanks. So I just want to point out a couple of things, maybe for the new Commissioners, that may not be obvious. Cross-commodity is essentially defined as any commodity that's not deliverable under the Exchange Contract. And what that means in the oil space is that, for example, sour crude is not deliverable under NYMEX contract, so that's a cross-commodity hedge.

The energy industry has got a wide variety of products that come out of the ground. Sweet, sour, different sulfur specs and the like, resulting in many, many cross-commodity relationships there. A variety of grades of gasoline, and gasoline itself is not deliverable under the RBOB contract, and then there were many, many different grades of gasoline. But on top of that you then have components that go into gasoline, and those are all considered cross-commodity.

So this is a vast swath of the hedging that's done in the energy space, and that's why it takes on, you know, pretty significant importance. Some of the commodities that I just mentioned would not pass the 80 percent test, and therefore, you know, the presumption was that they -- would be that they couldn't be used. The blend stocks that one might hold in tanks in New York Harbor that will become REBOB would not be usable -- you couldn't use the RBOB contract.

But then you shift into Five-Day Rule, and that says you have to get out in last five days, even if you would be using those blend stocks to deliver on the actual NYMEX Contract, that you were trying to hedge with. And that's one reason why he Five-Day Rule doesn't really work.

MR. McGONAGLE: But are you proposing sort of an exception to an exception? Not every situation is as you present, right? So, if someone is using your cross- commodity hedge, you know, in the normal circumstance, do they need to be standing for delivery?

MR. OPPENHEIMER: No. As I said at the

beginning, there are circumstances where we recognize the fact they will make some sense. That's one where it wouldn't. And I'm sorry, I could just -- two other points. There are also deliveries that we make, so we might have inventory in tank where we are making a delivery that crosses over that five-day period, it's completely inappropriate to roll out of that hedge. We are not hedged if you are taking the commodity in with that contract during that period, so that doesn't make sense.

The last point I want to make about the Five-Day Rule is that, you know, the Exchange monitors their liquidations, and so they are going to make sure that you have the product that you intend to deliver, or that you have the capacity to take the product that you're talking about, or they are going to get you out of that contract in an orderly way before the contract goes to delivery.

And the important point there is that that warrants additional flexibility in that five-day period, because what you don't want to do, is you don't want to chase the hedgers out of that important spot-month period, because that's how price convergence works, with having commercials in that part of the market. And if you drove them out, what you'd be left with are speculators in that period, and that's not what you want for orderly pricing of the contracts.

MR. McGONAGLE: So, before we go to David, Ken -- I was talking to Ken on the sidebar; to clarify a question that I had which is, I was talking about sort of what would staff be looking at, in order to evaluate the hedge. And then, Ken, presented the other perspective, it's really focused on how you would evaluate it. Where is it important to you, where do you draw those lines? Sort of, you know, back to this dynamic evaluation, how do these businesses make sense of where you get involved in cross- commodities? So let's go to David.

MR. PEARLMAN: Let me just say before I answer that question, the Five-Day Rule really does require focus and attention as Ron pointed out, and it's a little bit off- topic but we shouldn't forget that. You said before, Vince, is it -- you said art and science, and I think --

MR. McGONAGLE: Just as a question.

MR. PEARLMAN: Well, I liked it. And the real way to look at, from my clients' perspective of cross-commodity hedge is that it's an art, because if they could get a perfect hedge that was right on with their risk they would take it. And a cross-commodity hedge is sort of a second best, so that what they have to do is find something that works for them, in the event that there isn't a good match.

And it isn't just the question of, is the product available, there's pricing issues, there's liquidity issues, there's all kinds of things that go with this question. One example I can give you to look at is natural gas liquids. They had been hedgeable, you know, I think a pretty good correlation, at least I'm told, with WTI. And that, because of the natural gas revolution, et cetera, has diverged.

So the folks who are looking to hedge these things, they have to find something that works. You can get quotes on natural gas liquid swaps, now that's from a swap dealer, they are going to charge you a significant cost for that, because there is really not the liquidity that you would otherwise want. So the individual who is a seasoned market person, who is charged with hedging, is going to have to make a judgment.

Since we don't have the answer that we want, we have and we want to hedge, or maybe not, because of the expense, we have to pick the best tool that we have, and we will use our judgment and our professional, you know, experience to do that and the market will give us feedback as well, as we've said. In time, you could find out you were -- it was perfect or it wasn't perfect. But going into it, it's more, I understand, of an art than a science, and to cap it with an 80 percent correlation just makes it very difficult to have something that will qualify.

MR. McGONAGLE: Well then -- so it would be an expectation or a request that the determination by the firm, that the hedge -- that there is cross-commodity hedge is a presumption. A presumption that that's accurate that -- you know, so how do I evaluate -- well, how can I objectively evaluate that qualitative determination?

MR. PEARLMAN: Well, it's hard to objectively evaluate something that's inherently subjective in certain ways, because of the imperfection of the market here, but these people have to deal with the market on a real-time basis. And I think one of the things that we could have is that, as we've all talked about, there is nothing but documentation, internal to these organizations, to demonstrate that the activity that's undertaken, is for the purpose of hedging.

And maybe one thing we could do is, we could have a presumption that it is hedging, and it has got some level of correlation in the product mix. But it could be subject to audit or some other after-the-fact review, to have the Commission assure itself that the entity that was undertaking this cross-commodity hedge which is, again, based upon its judgment, was in fact taken for the purpose of hedging.

MR. McGONAGLE: Let's go to Lael, then Matt.

MR. CAMPBELL: Sure. I need to comment on this, because cross-commodity hedging is just necessary in the electricity industry, where there is just an undeniable relationship between the price of electricity and the price of the fuels that generate that electricity. You know, in certain markets at certain times, the price of the fuel is going to set the price of electricity in those markets. If gas -- if it's, you know, a time where gas generators are setting the market price, like electricity, the price of gas is going to correlate very closely with the price of electricity.

The bottom line is that, throughout the electricity industry, you know, the relationship between fuel prices, the prices of the fuel commodities and the price of electricity have been correlated. If you look at the Polar Vortex, you look at the -- what FERC has done in the aftermath of the Polar Vortex, really exploring the relationship, the interconnected relationship between how the gas markets work, and how the electricity markets work, making big changes to reflect the need to have a much closer unison between the way the physical gas and the physical power markets work.

Many of the electricity products reflect this correlation. We have heat rate products which we described in our letter and I may talk about later, but these products -- these are electricity products, or even financial products that are priced based on the relationship between fuel and electricity. We have tolling agreements or leases of electricity generators that are also priced often based on the cost of the fuel that would generate those facilities.

But the bottom line, to get to what

Vince said, is we are using cross-commodity hedges. Typically we'll use -- we'll go to the liquid product, we'll go to the markets that are most available to us, out the curve, further out, further forward in the spot month we are probably going to use gas, or something that's more liquid to hedge our electricity. As we are moving closer to the spot month, if there's liquidity in the electricity financial products, we may move the hedge into something that's more closely correlated.

But the bottom line is, and I've talked about this before. We have risk managers that are looking at our physical risk exposure, our financial risk exposure every single day. They are studying these correlations. If these correlations diverge, we are losing money, we are not hedging effectively, and our risk management group is going to tell the traders, get a better hedge.

Okay. So we have the built-in infrastructure in place. John Parsons talked about that. It's already in place at many of our companies. We are looking at these correlations, we are looking at the effectiveness of hedges, and as I said before, you know, I think the CFTC is often interpreting complexity as a potential loophole, but I really think you should be looking at complexity as -- you know, complexity demands flexibility, because these markets are complex.

We are managing risks of various things and various regions, the prices are changing all the time. It is very complex what our traders and risk managers do, and they need the flexibility to be able to do it effectively, consistent with the industry practice.

MR. McGONAGLE: Thanks, Lael. Before we go to Matt, Ken had a comment.

MR. DANGER: Just a quick question here. Again, this whole issue with cross-commodity hedging is really only focused on the last few trading days of the Physical Delivery Contract. So why is there a need to precisely hedge to the final settlement price on the Physical Delivery

Contract, if the hedge is a ballpark cross-commodity hedge? For example, why wouldn't a commercial enterprise try to lock in electricity supply prices, hedge in the short-dated electricity contracts whether derivative or cash forward, and get out of the physical delivery natural gas electricity -- natural gas futures contracts, as the natural gas futures contracts approach expiration?

MR. CAMPBELL: I can answer that real quickly. Sorry. You're talking about electricity, so I'll just answer it quickly. I think we would if we could. I mean I think we are going to seek the best hedge, the most liquid product to hedge our risk. So if there is liquidity in the electricity product in the prompt month -- spot month, sure, we'll use that.

As I mentioned before, you know, there are times where gas is setting the price of electricity in certain markets during certain times of the year, based on weather events. And in those situations gas is a perfectly well correlated hedge to keep into the spot-month period. So, again, it's less about -- again, it's about preserving the flexibility, not limiting the ability in the variety of ways that our risk managers can manage risks.

MR. DANGER: Is it a hedge if you're -- if you don't have production facilities?

MR. CAMPBELL: No. That's a different question.

MR. McGONAGLE: Go ahead, Ron.

MR. OPPENHEIMER: Yeah -- no -- I just want to say I don't see it as just an issue for the last few days of the expiring contract. If some of the cross-commodity relationships that I mentioned before were not permitted, we wouldn't be able to recognize them across the curve, with respect to any and all-month limits, and so it's a problem there as well.

MR. McGONAGLE: So let's go to Matt, he's been patient.

MR. JANSEN: Yes. Thank you. You know, if I think about the way the actual expiration process works today and, you know, you have the exchanges with the oversight, as well as Vince and his team with the oversight. I mean and in the -- starting even with first-notice day, and going into the expiration in many of the commodities and contracts where we operate, there is an increasing amount of dialogue between the commercial and the oversight.

On, okay, this is your position this morning, how do you -- how do you see the market dynamics today? And so, in terms of how do you -- your question about how do you evaluate that, I believe that that process is in place today, and it works. And that dialogue, I think you find, it's actually quite direct and to the point. And as you go into the -- you know, the actual expiration, there's an increasing amount of dialogue.

Or it's, okay, what are the economics today? What are the alternatives? And that is a process that I think serves us very well, and so I just wanted to respond to your question about how do you analyze that. It's really on a case-by-case basis because as so many have pointed out, that there are lots of dynamic inputs that influence these different commodities, but the -- you know, at the moment, and as the expiration is occurring, that's between the -- let's say, the hedger and the regulator -- whether it's the Exchange, or, Vince, in your team, that dialogue is, I think works well.

MR. McGONAGLE: Thanks. We are going to go to anticipatory merchandising in a second. Joe, your card was up.

MR. NICOSIA: I just wanted to touch briefly, when you're talking about the qualitative, quantitative tests that were there, and I would suggest that the quantitative tests, not only is not necessary, but it is actually the -- the actual opposite of what it is that you should be looking at, because it's not a matter that the correlations must remain stagnant or static to where it is, because the breakdown in the correlation is, in and of itself, a reason to use cross-commodity hedging.

If you took an example, and Mike touched on some of the simpler ones, if you had corn having to compete with wheat, the corn-wheat ratio very well may break down, but that's because it's either trying to force feed wheat into the marketplace, or it's trying to do the opposite. Another perfect example would be in the vegetable oils around the globe.

The fact that the relationship between soy oil, and canola or rape or palm, may break down from the point A to whatever you may consider to be necessary, might be the exact reason why, if you were trying to price out soy oil in the world because of shortage of supply, then the canolas and rapeseeds and others would become cheaper, you'd want to buy those, hedge them in soy, because then you can go to the end user, and as those spread become wider, cause the substitutability, the elasticity of demand, and the only way to lock that in, to allow you to present that to them, is to be able to buy the cheaper product, hedge in the more expensive product, and then allow the elasticity of demand to narrow those arbs.

MR. McGONAGLE: So would you leave it as an indicator for making the determination a quantitative factor, but not a requirement?

MR. NICOSIA: I think -- really I think it's more of a reasonableness test that's appropriate. It should be able to -- if someone can show you the need and/or the reasoning behind why the one is a -- as you would call it -- a Risk Mitigant Factor of why the ability to buy to canola and then sell soy oil as a relationship that -- most of the relationships are very obvious that exist, and some of them maybe need a little bit more explaining of why someone with an ethanol plant maybe buying corn and selling RBOB. Or something to the extent, that from there to ethanol, ethanol to the substitution into gas makes perfect -- really -- makes perfect sense at one point in time. So I think there is a -- it's much more of a reasonableness test, probably, more than it's a quantitative test.

MR. DANGER: I mean, your example about, market prices being high and low in different commodity groups, another perspective on that is in a way you are requesting hedge exemption to speculate on the cross-commodity spread between these two different commodities.

MR. NICOSIA: Well, in some of them though, because they are different commodities in and of themselves don't mean they are not in the same space. But even when those would leave space from one to, say, corn to ethanol, or corn to even eventually, to say an RBOB, it is a product of conversion that takes place, where you eventually reach that through the commodity and value chain.

So there is this relationship, and the difference there is you have conversion cost that -- your asset that takes place, you have your marketing cost. And at times the market will adjust, and our ability to move our hedges between commodities, is something that's very prudent to do. It's not adding speculation. It's actually doing what the market place is asking us for. You know, if there's too much ethanol relative to the demand in one point in time versus gasoline, the basis -- again this word basis -- is going to break down between those two.

When the basis gets really cheap that is a signal to go ahead and store the ethanol, but the way to lock that in, if you want to store the ethanol against the higher price of -- against the substituted gasoline, is you have to lock in the other side of that hedge. In order, so that you know that when the relationship comes back to a normal blend situation, you'll be able to capture that arbitrage, because otherwise you're just accepting the lower price of ethanol at that time, without the ability to be able to lock in, what you can do better with your product.

MR. DANGER: But that -- I mean, I think that's the basic question here. I mean, if you're talking about arbitrage, capturing arbitrage differentials, versus hedging, then the question is, when you took those positions, was that really a speculation in a sense? And you can view it as a hedge, perhaps, but there might have been -- it might not be fully risk-reducing, value neutral in a sense. And so you're able to take those positions to essentially capture that spread differential.

MR. NICOSIA: Yeah. But I don't consider that speculating at all, it's what is normally done in the norm of our business. That is our business; that is what we do. So the ability to prevent our assets from losing money, to being able to respond to the market call, to either hold back product, to store it or to create more of it, is exactly -- we have to be able to lock in the other side of the transaction.

MS. ADRIANCE: So this really -- what Ken is bringing up is that we are trying to -- we are going to ascertain, we or the Exchange has to ascertain, when is it speculation versus when is it hedging? You talked about a reasonableness test, but at some point along the way, somebody is going have to make a decision, make a determination, and what we are trying to get here is in a sense tools, what do we use? It's been mentioned that the quantitative test is a little too rigid, and the qualitative then is much of reasonableness and -- so basically it gets back to, what other standards do we basically -- are you suggesting that we put it back into the hands of exchange because they have the experience? Are you suggesting that we come up with a test? We have a test that is a useful test, and what would that reasonableness test involve?

I mean, basically what it gets down to is as, as was pointed out pointed out, we have to make this -- we have to understand what are we looking at, what are we dealing with, and how do we ascertain what is? And so our questions go to -- what Ken is bringing up is -- when we look at it, it may not look -- it may not be clear to us when we are at -- really serious intent to reduce risk, there's intent to manage risk.

MR. DANGER: How do you know today that it was a hedge, but tomorrow it was a spec position, right? I mean today it was a cross-commodity hedge but then tomorrow it's -- you know, really, you know, boss I really want to speculate on that derivative position, but I've got this physical here. And so when you show it to the Commission it will look like a hedge, but really your intent was to speculate. How do you differentiate between these two scenarios?

MR. NICOSIA: Yeah. I think it's important to realize that when you try to identify a hedge, no matter, even if it was the most perfect hedge. You know, you are buying corn in Illinois and you're selling corn futures. That in and of itself is a form of speculation, because it is a change, it is a hedge, because you are changing your outright ownership to a basis ownership. You may call it speculation, we would call it hedging. Someone else would just say, well, all you've done is change your risk profile from one of outright to one of relative; right.

It's a change in risk profile. The ability to get more -- right down to your point of how you try to identify speculation would probably be from the standpoint, if the transaction has absolutely no underlining cross relationship, or no underlining cross quantity justification. That's your answer.

MR. McGONAGLE: So, change is a good word to move on to the next topic. And let's look at anticipatory hedging and focus on merchandising. We want to get perspectives about how we could -- the Commission could consider a hedge exemption surrounding merchandising and how do we -- anticipatory merchandising, and how do we deal with the real challenge of articulating the satisfaction of the economic purpose test, that the merchandising, looking at potential contracts down the line, as giving a basis today to establish a position. Anyone wants to take that on?

MR. PROSSER: Thanks. Ed Prosser. I think at the heart of this, the Commission at this point starts to get a sense that this end-user class, this physical merchant is kind of a messy business. It's not cut and dry, things don't correlate well, there are a lot of risks that we are trying to offset inside of our businesses. If we had an enumerated product on a DCM for each one of our risks we could, 100 percent, hedge, go on down the road, and everything would be happy.

But unfortunately, that's not the real world we live in. We also don't just deal with price risks. We deal with weather risks, we deal with the quantity risk, we deal with quality risk, we deal with location risks. All of those risks we bring to the table, and we are moving into a few different enumerated commodities trying to offset those risks. We have developed strategies over decades to try to offset those risks on the exchanges.

We use time spreads to lock in carries. We use time spreads at times to offset weather risks, but all of these are a part of the function where overall we feel like using those particular contracts, reduce our risk from where we were if we weren't using them. Sometimes the correlations aren't as good as we'd like them to be, but they are the best alternative that we have. The other thing I'd like to point out, is by doing this activity, these physical merchants that have one foot on the physical side, and one foot in the derivative, do the good work of flipping those instruments with economic signals to bring convergence and price discovery to the marketplace, which is the most important function of all of these markets.

As we have each of those buckets, the opportunity to be in each of those sides simultaneously, or alternatively, it is very easy for me to determine, you know what, today the derivative is my best choice. Tomorrow the derivative goes back - it goes away and I go back into the physical market. And that goes on thousands of times, and ultimately it proves the great public good of converging the derivative to the cash. And that's what we do in this space, and it's a big part of that is this anticipatory merchandising, and anticipatory processing function that we use today.

MR. McGONAGLE: Mike?

MR. RICKS: Thank you. You know, when it comes down to the anticipated, in grain companies and probably energy companies too, you know, we are continually putting out bids to producers, offers to consumers on a real-time, 24-hour, seven-day-a-week basis. And we don't have the luxury of telling a farmer when he can sell to us, nor do we have the luxury of telling a consumer when they can buy.

They are the ones that hold the leverage, they make the decision. So, like all firms, you are analyzing that risk on a continual basis, and I think some of the rulemaking basically said, how can you hedge a risk that you haven't incurred yet by writing a contract. But by putting that firm bid out there, and that firm offer, every firm is going to assign some probability to that; and those probabilities are going to change day to day, hour to hour.

By sitting back and not managing those

risks, you are going -- one or two things are going to happen. First would be, is that all of a sudden that risk premium goes up. Let's just say if it's going into a big harvest weekend and we know we are going to buy a lot of corn, and we have the ability to pre-hedge those purchases because the market is not open on Saturday or Sunday, then we can stand in and buy that corn.

If we are not allowed to pre-hedge, then either we can't buy the corn, or we have to put a risk premium on it. The same thing when we are making an offer. A significant offer to a large sovereign entity, to a large food company, by assigning probabilities, and we are continually working on that, and that's one other reason why we can't do it on the enterprise level, because these are all localized decisions based on, you know, the wisdom of the people, and the experience of people. What are those probabilities?

And, again, to manage those risks, if we would wait, you know, until we consume that large sale, and then hedge, that has a potential to be more volatile, more price disruptive, and also is going to carry a bigger risk premium. So I mean from -- it's kind of the nature of the business because we are continually putting out a for-sale sign and a buy sign.

MR. McGONAGLE: Kristin?

MS. ROBERTUS: Yes. I would just echo the comments of my colleagues here, but I want to give you a simple example. So if we've had an unpriced contract, if we've had a sale that is not a fixed price contract, we still have a legally-binding obligation to deliver that grain. And so, if we are going to look at the market, and the market today is not converged, maybe the futures market is the cheapest source for us to purchase that grain. So we would go out and put a contract on, futures contract, as an anticipatory hedge that we know we are going to buy.

I would say it's not even anticipatory, we know that we have this obligation to deliver the grain. We know we are going to buy it. And back to Joe's point, we don't have that flat price risk, but we have that relative value of the futures price that we have agreed to use in the future with the customer that's buying the grain, and the cash price today that's not converged, the May futures contract, potentially, that we would be buying as a hedge. What we would do in that situation would be to sell that deferred contract and buy the current contract if it's cheaper to do that, and that's risk-reducing for us, because it's locking in that spread.

MR. DANGER: I just wanted to tee up a very simple hypothetical on anticipatory merchandising or processing. So again, I want to abstract from the very complex world that you operate in, and just think about this.

So we've got a firm that started up. They have no sales, no fixed-price sales, no fixed-price purchases, no inventory whatsoever. They then decide what -- they anticipate selling a lot of -- or merchandising in the future, anticipate selling a lot of product in the future, and as a result they go out and put on 100,000 contracts in corn, in the corn futures contract, the physical delivery contract. And then they go to CME or CFTC and they say, well, this a bona fide hedge because we anticipate selling this forward.

And so my question to you, and I want you to think about this, I guess during the break, and then we can come back and talk about it, is this reducing risk for this firm, or is it increasing risk?

MR. McGONAGLE: So, Ken, it comes back to the economic purpose test. But I know Joe had his card up.

MR. NICOSIA: Thank you. In regards to the anticipatory hedging, as well as the inclusion of merchandising, a couple of comments; one is, currently the statute had merchandising in, and it was then removed; the question is whether it should be replaced or not. But it clearly also stated, besides merchandising, processing, producing, end users, where it recognizes the need for anticipatory hedging.

But even within that, a processer, an end user, after conversion is a merchandiser, because they have to sell their product, they have to market their product, transport it, store it, they make all those decisions that are being done completely as a merchandiser. So even within the realms of what you have, their activities are merchandising activities, which clearly are acceptable within the statute that's there.

I think one of the other things that's important, and we are mentioning again about the ability, it's also the definition of what is an anticipatory hedge. Because I would echo what we have just heard, the ability to go ahead and procure supply against a fully-committed sale, the fact that it is a relatively-priced risk as opposed to an absolutely price risk, is not anticipatory at all. That boat is showing up, and you'd better put grain in it, or you're in default. And the fact that he is not going to price till a day or two before that boat shows up, in no way removes the obligation that we have to perform in order to move our farmers' grains into that boat from where it is there. It is simply not an anticipatory hedge whatsoever; it's a normal course of business.

MR. McGONAGLE: I think we have -- in getting back to Kristin's hypothetical, or real-world scenario, a couple of specific items after the break that we want to get into and sort of unpack -- un-package that a little bit more. Ron and Ed, as between you two, and I don't know who had the card up, so you take us to the break, Ron.

MR. OPPENHEIMER: Okay, thanks. I'll be very quick. Two things; first is, you know, you look at the question and you say is there a basis for granting an exemption for anticipatory merchandising transaction that establishes price risk. What you heard around the table is, they don't establish price risk, they mitigate price risk, and so the question is backwards and, you know, all of the comments are that these transactions reduce risk.

The other point I wanted to make was with respect to Ken's question, is that there's a process that is in place that works, and that should mitigate any concern that Ken has. Okay. On the federal level, if you were going to use an anticipated production hedge exemption or an anticipated requirement exemption, you apply in advance. In the energy space, where we are not under a federal regime, we go to the NYMEX and we make a case. So if we are brand new, and we have no contracts, and we have no employees, and we never chartered a ship, NYMEX might look at us and say, you're crazy, you're not getting a hedge exemption for that.

But if we've been in business and we have the right staffing, and we have the right systems, and we can demonstrate that there's a real probability that we are going to be doing that business, we might convince them. And on top of that, they have the ability to say, you know what, we don't like 100,000, that doesn't work in this market context, you can have an exemption to

50. I don't know what the corn levels are, but the point is, they have the ability to moderate that, and we have that going forward even under the new federal limits for energies and other physical commodities.

MR. McGONAGLE: Great. So let's go -- oh, Tom.

MR. LaSALA: Just real quick, to echo Ron's words. What he said was accurate, Vince. You know, in that very, very scripted tight hypothetical that Ken put out, the likelihood of an exemption there with -- you know, we just started up, we've done nothing. Now let us get that exemption? No. That's impractical, but where you've demonstrated, you know, I have sold and distributed, this history, that is frankly what we look at, and it is, I think again, just to state for the record, regardless of what the underlying exposure is for any exemption. I think you know that exemptions are not just simply blanket; meaning that, yes, you are exempt, go with your free will, unbridled, enjoy.

It doesn't simply work like that. We look at what the liquidity profiles are in the market, even if you have requisite exposure, we look at what the open interest is, what the liquidation patterns have been in the contract to make sure that we are not granting an exemption that gives someone undue concentration or control, so there is quite a bit of review process around, you know, what you grant in terms of exemptions modifying the ask down, tiering those numbers down.

MR. McGONAGLE: Okay. And I appreciate that, Tom. So we are going to take -- we'll take a break, when we come back we'll have about 45 minutes. We are going to talk about testing, firm bids or offers, synthetic fixings, unpriced physical purchase or sales; and then a process surrounding whether there should be an un-enumerated hedge exemption review, and we'll try and do that within 45 minutes.

It's about 11:05, if we can come back at 11:20 that would be great. Thank you.

(Recess)

MR. McGONAGLE: So, before we went into the break we talked about some specific -- we wanted to get into some specific examples and, again, the focus here from our perspective, from the Staff's point of view is, we really want to get into the details and get as concrete an understanding about how best to evaluate these issues. How these risks are evaluated at the firm, how that information can be reviewed by the Agency, so we can make, you know, meaningful decisions with recommendations with respect to this rulemaking.

So as concrete as you can be during the remainder of the session is, of course, very helpful. I do want to turn it to Ken to walk through some of these specific hypotheticals, or scenarios, on hedging to get your perspectives on where we can draw some lines.

MR. DANGER: So I think what we can do is, we can draw together one of the comments by Joe, and then another comment by Kristin with respect to hedging unfixed price contracts. So, the specific question on the table here is, can you hedge unfixed price contracts, forward commitments to supply or purchase with fixed-price future contracts? Or alternatively, would it be better to hedge those unfixed- price forward commitments with another unfixed-price commitment?

And so what I'd like to do is to help us think about that, is to draw on the experience of CME. And look to Tom and say, Tom, what's your thoughts, what is -- on hedging basis risk -- basis contracts with fixed-price futures contracts?

MR. LaSALA: Ken, in the enumerated space, I believe that we are bound to have both the legs, like the purchase of the basis tied with the sale. So you could have basically a spread, if you are buying basis on one month, selling basis on another month, we look for the pairing. That's the -- in the enumerated space I think that -- I would say that that's the standard that Joe Hawrysz's team would abide by.

MR. DANGER: You're right. So there is an example in CFTC regs that focuses on basis contracts in different delivery months, but I want to focus on just a very simple -- again, it's to help us to focus on the most simple possible example, because our complex world is built up on simple things. So, if you have an unfixed-price contract in one month, right, out the curve some point in time, can you hedge that unfixed-priced commitment with a fixed-price future -- fixed price contract?

MR. LaSALA: You've got an unfixed purchase somewhere out the curve?

MR. DANGER: Sure, yeah. So you've promised to purchase corn six months out, based on whatever the futures price will be at that particularly point in time.

MR. LaSALA: And you want to --

MR. DANGER: Can you hedge that with a futures contract? So that's the question, and so --

MR. LaSALA: Forgive me. Is the hedge

that you are looking to sell futures?

MR. DANGER: Sure. I mean, in this particular case, or purchase. You know, that's whatever you think is appropriate there.

MR. LaSALA: Again, I question maybe -- the sale is not obvious to me in that hypothetical, but if in fact you were -- you purchased futures in connection with it, and there was another sale of futures, that somehow represented something that was along an anticipatory line, I think that package could be something that would be acceptable.

MR. DANGER: I think what, I mean, Joe and Kristin were saying was that when you've got unfixed-price commitments to purchase, what you'd want to do is -- and I think what they talked about is, hedge that risk through the fixing of -- making sure that you have commitments to satisfy or to get rid of that risk, and the way to do that, is through -- potentially through futures. So maybe Joe could help us out on what his thoughts are, and maybe Kristin.

MR. NICOSIA: Yeah. I'd like to take you through a real life example, and maybe it's a little long, so please excuse that. But let us say -- let us start with we sell 0.5 million tons to the Chinese, unfixed, for January delivery out of the Gulf. Now, at that point in time all we have is an unfixed sale, but we know that it is a real commitment that we have to go through. All right, so now let's go ahead and cover that, because your question is, there's different ways to cover that, so let's cover them all, and see what should happen. Let's see what the differences are.

So the first day I go in; and let's say I've sold -- not to get too complicated, but let's just say that I sold it at 90 over to January. I go into the barge market and I'm able to buy barges the next day at 82, so I buy them, and they may be on call, so I buy some quantity, that's fine. The next day there are barges offered to me at $12.50, which equates to 88 over. I buy it at $12.50, I sell the January, that's the proper hedge. You would say that that's okay.

The next day I move on to the Illinois River, somebody offers me 90 over down there, I buy them from them on call. You say that's okay. Then I tell you, oh, by the way, yesterday those 90 that I bought on call, that 90 undelivered, they happen to be registered delivery stocks. But I bought them from the elevator -- the owner in the elevator, who just happened to sell them to me at 90 over. You'd say that's fine.

The next day I turn around and I buy some more, and I buy them at 12.50, and I hedge them in the January, at 90 over. And then I turn around, and I tell you, oh, those I bought at 90 were also delivery stocks but I bought them through the CME, because the elevator operator who had those other stocks now wanted 95. So I bought them because they were cheaper, but they were the seller through the Exchange, but in order to buy them through Exchange I needed a long November future, you tell me no, you don't have the right to have a long November future in order to procure your cash.

I can buy the same grain, from the same person, yesterday, and you say it's fine. But because I bought it from him through the Exchange, you tell me I cannot do that. That is not logical. So, I do need the ability to be able to have a futures position, to be able to procure my grain, and in that particular case, what we would do, is we would buy November, sell January.

That would be the equivalent, because it ends up, when it comes to fruition, delivery, it turns into a basis trade that offsets our delivery risk. But since it is the cheapest source of cash, it is the equivalent of buying cash at that point in time. And thus it is a legitimate hedge and a reason to have it done that way.

MR. DANGER: Kristin, did you want to follow up with any comments there?

MS. ROBERTUS: Now I would say I agree with that example. I think in our example too, what we were saying is if we have this legally binding obligation to deliver and it's the cheapest route to do that, we will do that. Again, we would sell, in his example, the January, buy the November, but in our case we would say, if the -- that would be if market is not converged -- if the market then converges, we will get out of that spread position, we would buy back the January, sell out the November and then go into the cash market and buy that.

But in our example, too, if we are pricing with the Chinese in January, we'd likely have agreed with them that we will take an exchange of futures. We know we are going to get a long futures position from that Chinese customer, and we are just shorting that, it will be covered when we price the contract. So, you know, in our example we are saying, this is happening, and when it's not converged, and we believe that we're reducing the risk that we have, and we are also promoting convergence in the market.

MR. NICOSIA: And to add onto that real quickly. In that same example that I used, if the very following day the Chinese priced their contract, where it turned to fixed and we had the futures, which is exactly the same. It is a basis contract, exactly the same as it was the day before, the next day when I came to you and said I'm going to procure my beans on the November. You would say okay, because now it's a fixed price with a future versus being on call, which are exactly the same things, but you draw that distinction between the two, when the relevance to us is exactly the same. There is absolutely no difference between those two sets of parameters.

MR. McGONAGLE: Tim?

MR. BARRY: Yeah. I just want to say, you know, we have both enumerated and non-enumerated ags, and the type of transaction you're describing, and what Joe was just describing, in grains, it's something we see all the time Coffee, Sugar & Cocoa, and we have for years -- you know, we've been able to document the bona fide nature of the unfixed price call, sale or -- call, sale or purchase. But we've routinely used them, and seen them work well, for hedge exemption purposes, and for purposes of managing the risk that the commercial parties have. So, it would not be unusual at all in those spaces.

MR. McGONAGLE: Kristin, and then back to Lael.

MS. ROBERTUS: Yeah. I wanted to point out, also I think further to what he was saying. In our example, if the market wasn't converged, even if we had that fixed price contract on that July sale, we would take exactly the same action. We would sell out the January and buy the November if it was the cheapest option. So it would be no difference to us the way we would hedge that if it was unpriced versus priced in a market that wasn't converged.

MR. McGONAGLE: So we are -- we are asking back and forth here, and what's come up a couple of times, so in looking at these hedge exemptions, so we focused on price risk or some performance risk, and what is the intention of the hedge? And so, you know, we are not talking, in a

number of these instances about price risk, you
are talking about -- or are you talking about
performance obligations? And so how do I get your
concerns about whether you are going to get your
product, or be able to deliver your product, risk
concerns surrounding who the counterparties are,
on to an idea of evaluating whether you've
increased risk and are therefore not entitled to
seek an exemption for that reason.

MR. DANGER: A simple -- to tee up the
hypothetical here, or an example, which is, is the
combination of an unfixed-priced contract, and a
fixed-price contract, in these examples that
you're working through, basically the same thing
as just buying a fixed-priced contract? In other
words, with the fixed-priced contract, when the
prices change in the market, the value of that
contract changes, but with an unfixed-price
contract the value of that contract isn't really
changing; there's no real price risk.

What you've got is performance risk, and
so what you have is, with unfixed-price contracts,

you've got concerns about the performance on that contract. And so what you want to do is, from a hedging perspective, is match up those risks, and a way to do that, and I'm looking for your thoughts on this, is the way you do this, with hedging that unfixed-price commitment with another unfixed-price contract, rather than a fixed-priced contract which would seem to establish price risk. Or am I getting it wrong?

MR. CAMPBELL: I mean, I want to look at it from the aspect of a purchaser of an unfixed price, a physical forward, you know, and I think, if you are a purchaser of a physical commodity at an index price, you have price risks that you should be able to hedge. So, for example, if I am an electric generator, I have a fuel requirement that I need to fill. I may enter into an unfixed-price physical contract to lock in my supply and make sure I have the supply risk taken care of.

But just because I've locked in my supply risk and taken care of that, I still have price risk, because that forward, physical futures contract for fuel is at a variable indexed-base price. I have price risk in the future and even though it is unfixed, I as the generator should be able to hedge that risk and lock it in when I see the opportunity to.

MR. DANGER: Does everybody agree with that. I mean, is that all unfixed price contracts have price risk? I mean, is that the consensus here?

MR. CAMPBELL: From a purchaser's standpoint, absolutely.

MR. McGONAGLE: Let's go to John.

MR. PARSONS: Yeah. So, if you break this hypothetical of the supply into two pieces, which is the contract to sell, and the obligation to purchase, clearly the obligation to purchase whenever you enter into the future, you are reducing the risk, right. Because you have an obligation at an unfixed price the moment you execute the futures contract, you've reduced the risk on that one half of the obligation.

It is true, though, that you've left yourself wide open on what are you going to receive for the stuff that you are procuring. So, you know -- I mean I see where you are coming from, the total risk is higher, but that was true, the moment you made -- in the hypothetical he constructed -- the moment you did the unfixed-price sale, you created this risk. Now when you go and procure a piece of it, using something that is deliverable on the contract -- on the futures market, at a fixed price, you are reducing the risk on the procurement, but you're not reducing your total risk.

MR. DANGER: So it seems like -- I mean just -- you disagree with their ideas on, that it is a risk-reducing transaction?

MR. PARSONS: Yeah. I think I'm trying to find a way to incorporate what people are saying, and clarify. It's clearly a mechanism for securing -- for procuring your supplies, so you are going out and doing, and what they are looking to do is do that at the cheapest price. You are not reducing your total risk exposure.

MR. McGONAGLE: Ed?

MR. PROSSER: I would like to first point out that the best way to start a speculative trade is not to sell a half a million ton of soy beans to the Chinese. Ken, if there was a perfect hedge. If there was a basis- only trade, is what we would call it. Or an unfixed entity, or trade option out there, we could use that. We spent all this year in Dodd-Frank trying to make sure that we get back on Exchange.

Surely we are not wanting to push us back off into non-enumerated commodities in the ag space. I mean, I think what we are trying to get across, I hope we are getting across, this idea that we are on this continual search for the best hedge that we have. And a lot of these times we make the choice of between the best of two bad options, but it does reduce our risk, because we do have an obligation. Certainly when that boat shows up in New Orleans we've got to load it, and there are opportunities to mitigate some of that.

Is it perfect? No. But it's the best that we have today.

MR. McGONAGLE: So looking at your -- the example that you started with, so where do we -- where can we -- where would you put our markers for identification? And you know, there's actually going to be an offsetting transaction that justifies establishing this -- you know, as someone referred to earlier, this pre-hedge. How do we -- how are we going to articulate that in this anticipatory world? Where do we -- what should we be looking for? And how the firm is managing its business, and how you're representing that, the need for the hedge to us?

MR. PROSSER: I'll let Joe finish, but I would think that in --

MR. McGONAGLE: A number of flags up now, yeah.

MR. PROSSER: -- in the beginning all of those things that we've talked about so often, the 204s, the process we go through with our DCMs on hedge exemptions, again, if you are a new company and just show up with a fixed -- with an unfixed hedge, the CBOT is going to start to ask questions. Have you ever done this business before? What are you trying to do? I think they are all --

MR. McGONAGLE: So it's all facts and circumstances approach effectively? I mean, that's what we are hearing.

MR. PROSSER: In Gavilon's opinion, yes.

MR. McGONAGLE: Yeah. David, Joe and then we'll go to Mike and Kristin--

MR. PEARLMAN: Yeah. I'm going to make a very quick comment, and just in furtherance of Lael's example, because in the energy world, in the purchase scenario he was describing, very often the unfixed supply sale, is from a counterparty that doesn't have a strong balance sheet. So if you can get a firm, fixed price from them that would be fine, if you were comfortable with their credit. Because if they default, then you're not going to be able to get the mark-to-market value that you would get because of the credit concerns, and you are not going to be able to do that deal.

So you can bifurcate and actually do an overall risk mitigating transaction by buying at spot market from someone who was a logistically capable supplier, who is going to have no issues supplying you something at spot market and getting it to your location. And then you go to the Exchange and you hedge that with a hedge that is going to be credit, completely bulletproof.

So you've got both pieces matched up. You have your supply at a very reliable manner brought to you, but you couldn't fix that price and rely on that supplier. And then you have a way to fix your price, and resolve the credit issues you would otherwise have with the supplier and you've reduced overall credit -- I mean, overall risk, pardon me.

MR. DANGER: I heard you say something slightly different than what we started out with. Which was, we have an unfixed -- you have an unfixed-price commitment and then you went and fixed that price through a spot contract, and then you hedged that price risk associated with that spot -- fixed-priced spot contract with futures.

MR. PEARLMAN: I was going to -- I was commenting on Lael's example which was, you were making an unfixed purchase, and then you were -- effectively that existed, and then you were fixing that price with the futures.

MR. McGONAGLE: Joe.

MR. PARSONS: In response to your two questions, on the end of the -- the one that you just asked, which was, how are you able to look at the need, or the ability to make a determination about that hedge being proper or not? And you had that information currently that is available. You'll see, in order to be able to have that to justify its position there's two things, the cash market will have to converge and that the delivery market is a cheaper source of supply, either due to time, location, price, quality.

And the other thing is that you have an offsetting need. So if you turn around and you're long 20 million bushels at the Gulf as opposed to a short 20 million bushels at the Gulf, it's two very different needs of what it is that you have. You have that information available so that you would be able to see that and determine it.

To the other question that Ken had asked about is it a risk-reducing transaction, and in this case I fully disagree with John. It's absolutely a risk-reducing transaction. As a matter of fact when you bring it to the end, it completely closes it out to zero, so your ability to take the November, sell the Jan, that is the same thing as buying 90-over at the Gulf.

The fact that you bought it through the Exchange because it was a cheaper source of supply, should in no way have anything to do with changes of risk. It's not taking on flat price risk, it's substituting a purchase of basis for the other, because by being long the Nov, when we look at only the Nov it looks like you are just going long one month and it's a flat price.

But if you have -- offsetting other

positions, whether it's a sold January a sold March, you'll have it as a basis contract, and that is an almost perfect mitigant against that basis sale that you have.

MR. DANGER: I mean, I don't want to speak for John, but I mean I think that John is going to say something like this; which is, that when you do that fixed-priced contract, which is the "risk-reducing transaction" in this case a long futures contract, if the price of that long futures contract goes down, then you suffer a loss on that position.

MR. NICOSIA: No. You don't. Because you are offsetting, it's the short against the Jan so as they go down you make it back against the January. So the November goes down you lose, but you short the Jan against it, you've locked in 90-off, that's exactly what we do when we hedge, that's the basis. So there is absolutely no flat price risk in that scenario whatsoever.

MR. McGONAGLE: Kristin, and then Mike.

MS. ROBERTUS: No. I would say the same

thing. In John's example I would agree, if the only think we were doing was going long the November, but the situation we are talking about, going long the November and going short in the January, is risk-reducing. We are completely offsetting both legs of that transaction, so it is risk-reducing.

MR. McGONAGLE: Mike?

MR. RICKS: Yeah. I would be redundant at this stage because I -- those were the points I was going to make. If you have an unpriced sale, is it appropriate to hedge it with the flat-priced futures? No. Is it appropriate to hedge it with a spread position; long the nearby, short the next month? Absolutely. Is it appropriate to carry that long, nearby futures position offset with a short in a deferred into delivery and use that as a way to fulfill that sale, if that is the cheapest source of cash? Absolutely, that's how these markets work.

And to deny that just because -- whether a contract is priced or not, is purely happenstance. It's the buyers right to decide when to price. I mean it's how they manage their risk; so whether it's priced or not, it's a commitment, and that's all the people are trying to say.

MR. McGONAGLE: Ron?

MR. OPPENHEIMER: Yeah. Just a couple of things; first is, calendar-month average pricing wasn't in your series of questions, but this discussion goes, you know, almost identically to that, and so, you know, if we want to move on and just park that one, and recognize that when you go back and analyze, whether or not to grant that exemption.

The other point I wanted to make, and it's, you know, I love hearing the traders talk about it, because they do ways -- do so in ways, I can't, but you know what I'm hearing, and I think it's appropriate to pull back just a little bit, is the questions in this discussion and in the one on cross-commodity was really about the subjective valuation of the quality of the hedge; and not at all about use of anything for excessive speculation.

And I think it's really important again that we pull back and we think about what these rules are here for and what they are intended to protect, and whether or not it fits in exactly a definition that exists, and has existed for -- you know -- in the statute for, you know, tens and decades, and scores of years, isn't really the question. The question is whether or not the Commission should recognize it today, and I think the overwhelming answer that you hear from the commercial side is, it has to.

MR. McGONAGLE: All right. We are about ready to go to the second Panel. You all are participating in the second Panel, so please don't get up. But before we do that, we want to check; is there any area in the conversation today, on hedging, that we've missed, or that needs to be underscored? You know, Ron just brought up one other item that we hadn't talked about, and I just want to touch that base now, as you were thinking about what we've discussed this morning, if you have any sort of final short remarks, let's get those. Joe?

MR. NICOSIA: Mine will be real short. I hope our Panel today has been able to provide you with enough information of why you need to re-include merchandising into the statute language. Thank you.

MR. McGONAGLE: David?

MR. PEARLMAN: Riva had asked at one point, should we let the exchanges make these decisions, or how should we deal with these things? And my answer to that question is, yes. They are doing a great job today in using, in the non- enumerated space, their knowledge and understanding, and have the dialogue with the folks who were seeking the exemptions. And if there is any way that that expertise can continue under the new regime at the Federal level as well as at their level, that would be much appreciated.

MR. CAMPBELL: I just want to reiterate that -- again, that our companies have risk management teams that are analyzing and assessing these risks every day. And, again, if we are not doing it right, if the trader is not hedging properly or doing it right, he's losing money for the firm and he's not doing his job, and there's going to be consequences.

But, please, do not limit alternatives, do not limit ways that companies like ours can manage risk. At the end of the day, when you limit ways to manage risk, that is going to be reflected in higher prices for end use consumers.

MR. McGONAGLE: Anyone else? Yeah? Okay. So let me move to the second Panel. And what I like about the second Panel is it talks about a process for non-enumerated exemptions, and so in my mind, that means we've figured everything else out, and now we are looking to see what else could -- needs to be done on a going-forward basis.

In the Notice of Proposed Rulemaking, there was some commentary about how to handle, sort of, transparency. You know, the transparency goal for non -- for determining further exemptions. And so we put forth to the Panel today, this question about whether we should reserve back regulation 1.47, and if we reserve back an opportunity for individual request for non-enumerated exemption, how can we do that in a way that informs? How can we best do that in a way that informs the public? So I'll sort of start with that general policy question, and solicit your comments about whether and how we should reserve 147. Go ahead, Ron.

MR. OPPENHEIMER: I'll take a shot. I think that you have to look at it in two ways, and I may not offer you a solution to both ways, but you have to look at it in two ways. Some of the requests under 1.47 are for systemic types of changes. You know, structural changes, things that -- new types of transactions that hadn't been considered before. As they have been in the past, most of the requests were for hedging swap risk in ways that it hadn't been done before.

And those were sort of -- I don't know

what the right word is for it, but maybe call it a class exemption. And those I could see the need and the benefit from a public comment type process. But when you look at the things we've been discussing today, and the things that were in the Working Group's petition, those will come up on a transaction-by-transaction basis.

And there's just not time, opportunity, or really an appropriate need for subjecting those to public comment, and for subjecting those to the lengthy period of time that would be necessary for that. And it will impede the ability to do a commercial transaction in the speed with which it has it be done. So I think you need to -- you break it up and look at it in two different pieces.

MR. McGONAGLE: So let me draw that out a little bit, because we've, I guess, received some comments or questions concerning whether, at the time of an application for an exemption, that the firm submitting the application is good to go until told otherwise. And whether that's a good process, and is that a good -- why would that be a good process?

MR. OPPENHEIMER: I think for the individual transaction it should be. I think maybe we'll look at Tom a little bit but, you know, when you're dealing with the Exchange, again, what you do is you apply in advance for a hedge exemption. They tell you the sort of scope of what you can do if you have an individual transaction that you need to do, you can do that within that umbrella. With the structure that is being set up for federal spec limits, you don't apply in advance necessarily, and then you just notify afterwards.

And that flip of the process is what's creating this problem for you, I think. And so I think if we revert back, again, to an Exchange process where, perhaps, you've either told the Exchange in advance in your initial application, or you go to the Exchange with the specific transaction, you'd be in a position where it got a level of review in a timely fashion, and the commercial firm was able to do the transaction they were looking to do.

MR. McGONAGLE: He's drawing you out, Tom.

MR. LaSALA: So he is. Vince, I do think that the Exchange would have an appetite -- I know that Tim also -- you know, has some thoughts on this, so I'm not going to speak for him, but I think the exchanges would be open to a 1.47-like process but -- but whether you would say, we are doing it on behalf of the Commission, we are doing the initial review from the participant, by the DCM, passing those results on to the Commission.

I think there's an appetite there where we can be an effective tool in assisting this process. I think there are some -- certain conditions or stipulations we'd need to make in that. I'd say that, you know, we are acting in good faith in reviewing the facts and circumstances, and the appropriateness, as you would --

MR. McGONAGLE: But would you be making that information publicly available? Sort of, you know, masking in some respects I guess, the nature of the request, but giving information out to market participants, so that they otherwise can rely on the exemption that's been provided?

MR. LaSALA: In what I'm contemplating here, I hadn't; however, I think that there should or -- there could or should be some type of a means by which, if you see DCMs coming to the CFTC with repeat comparable examples that may be the stimulus for the Agency to maybe even possibly look at those types of, what you might call, currently non-enumerated. Maybe they should be, in fact, enumerated.

So I think, again, a process could yield light to that. But I do think we need some type of an understanding that in conducting that activity, we are doing so in good faith, we may render those decisions that the Agency, if you decide otherwise, in hindsight, that you don't agree, that we haven't somehow violated any kind of a core principle.

I think we also probably need to consider some type of a structure where we are not drawing disparate conclusions, such that I think it -- you know, example X seems to work by my review, or my team's review of the activity and another DCM's review is to the contrary. I think we have to contemplate how we would do it.

MS. ADRIANCE: It seems as if what you are suggesting is a maybe an additional process, I mean there was 1.47, there was the Exchange processes, there was the proposal which did not continue 1.47, it's seems like you are talking about a third, fourth alternative, which was in a sense, perhaps, a joint effort between the DCMs and the Commission, that you're envisioning. And I'd just like to have you, kind of, explain maybe a little further as to what -- how you think this might work in terms of -- it sounds like you thought each Exchange could do, you said, the initial review, then it would come over to the Commission. What is it that you say is the most productive, most -- well, timely, productive, and efficient way to carry this out?

And we would like to hear. And we've gotten all kinds of comments as was mentioned. We would like to hear from your perspective, and I'd like to actually hear from both of your perspectives, both exchanges, what is it you view as the preferred way that we should look at this? Because I mean we've heard some of the -- you know, from some of those who use these things, they want just the most timely, the simplest ways, obviously, the best for them. What is it from your perspective?

MR. LaSALA: Riva, again, you know, frankly the questions that were posed to the Panel are what provoked the thought as to --

MS. ADRIANCE: Yeah. You're right.

MR. LaSALA: You asked for other alternatives, and so I did certainly give some thought to what those alternatives could be, and there was an eye towards an expeditious handling on the part of the participant applying. You know, some -- let's call it, you know, 30-day window--some structure where the information comes to the Exchange, and we've got a set amount of time to respond. If we have questions, we'll have the ability to go back. We have then the ability to, you know, do one of, maybe probably three things. Grant it, deny it, or if the -- you know, the party doesn't seem to be satisfying us, and we are saying we don't see this right now, they could potentially withdraw it.

You know, let's say, for example, we pass on it positively. We advise the Agency, send the file over, you've got an ability there to review it. Again, that seemed like an expeditious means in attempting to process these. I do thing that you'd have to have some kind of a process on your side, where you're looking at the totality of these documents that are coming at you, and to the extent that they are consistent, maybe you want to have a process where you consider moving them into a more enumerated type classification. If you see a conflict I think that's probably a bad outcome, and that should be brought to the attention of the DCMs. Or if you see it, you know, again, somehow intercepted, we -- again, Tim and I haven't talked about it at length, maybe there could be a process of information-sharing during the initial process, so that we can collectively see that we are on the same page.

So I can't say to you that I've thought from front to back, every possible step, but it was simply an attempt to come up with an alternative that I think that the industry was looking for, because their concern was expeditious answer.

MR. McGONAGLE: Tim?

MR. BARRY: Yeah. I would agree. And this is, I think, one of the happy circumstances where each of the two exchanges looked at the documents in front of us and came to the same conclusion. You know, you almost suggested that, in your question number three, are there alternatives to the procedure such as exchange review and approval that would support a pre-approval reliance. I think we both -- the light bulb went off on both exchanges at the same time, that absolutely, that would be an expeditious, appropriate process, with the protections that Tom mentioned for the, you know, presumption of good-faith actions on the part of the exchange, and that the commercial entity who has gone ahead and relied upon the initial favorable ruling from the Exchange.

You know, we haven't talked in any depth about trying to find a mechanism to ensure that there would be consistent treatment across the different DCMs of similar circumstances. That's clearly is something that we probably should think about. Obviously anything that would be done, would be done subject to CFTC final approval and review, and that would help provide a forum for ensuring that the two exchanges don't have disparate outcomes in similar circumstances.

But it does seem to be a reasonable route, to try to address the concerns of the commercials that this new process at the CFTC alone might take too long. While, you know, still meeting your objectives, and I think that --

MR. McGONAGLE: So then the question there, in terms of what is expeditious versus what is time-constrained.

MR. BARRY: Right.

MR. McGONAGLE: So if there's some marker that's 10 days and yet you are hearing some of these strategies that are very complex, then you have the ability at an Exchange or at the Commission level, frankly, to consider the nuances in order to consider the application, including the more broad application, not just for the submitter. So, I think that's some of the items that we are trying to get at, and you know, the management of resources of course by the Agency as well as the exchanges shouldn't be diminished.

MR. BARRY: Great.

MR. LaSALA: Yeah. Vince, one additional point, and I don't mean to be a kill joy here, but I do think that we'll probably have to think a bit about maybe certain restrictions with pre-assuming positions, depending on the market. You know, for example, energy has got a three-day spot period, if something is -- you know is -- this is an un-enumerated application to assume that position and with only three days to liquidate if we didn't agree.

You know, there's liquidation circumstances that could come up, so I'm just simply saying I would have to give some further, you know, thought to that, and I mentioned it to Tim. And not all markets, we know they are not all the same. Some of them have got a lengthier delivery period, maybe in some it would be appropriate, you could look at this in the spot-month circumstance, I might be a little bit more reserved than other markets that have got a very, very compressed spot month period, and want to get that application in advance.

MR. McGONAGLE: All right. So I'm a little mindful of time, but I know John has been patient, so.

MR. WETJEN: Vince, can I jump in real

quick?

MR. McGONAGLE: Of course.

MR. WETJEN: Both of you mentioned the desire to have some sort of presumption of good faith on the part of the Exchange if you are reviewing these requests. But what would -- what do you have in mind? Do you have in mind basically an understanding between staff and the DCMs? Or, do you have something more specific in mind? I'm just kind of curious what exactly -- I mean we always presume you are all acting in good faith, in other words, I mean.

MR. LaSALA: Commissioner Wetjen, I think that what we were both just simply thinking is, yes, we are acting in good faith. If for some reason the staff, you know, ultimately in review, concluded otherwise we -- our comment between us is, we'd hate to see a core principle action, you know, coming against -- you know -- either of the designated contract markets. I'd like to think that wouldn't happen, but that's just simply the concern. We certainly act in good faith, and it would be our intention to do so.

MR. BARRY: Yeah. Precisely, and if we are going to set this up under Commission regs as an appropriate process, we don't want to find ourselves subject to adverse actions at the end of it, if we've acted in good faith.

MR. McGONAGLE: John?

MR. PARSONS: So, there are lots of ways of structuring something like this, and most of which, to pay attention to all of the different considerations, most of which are beyond me. I only have two simple points. One is, I think it's very important for the Commission to have internal to the Commission the capacity, and that capacity is only going to be there if it's regularly exercised.

So if there's deference given to other institutions for large volumes of these things, or speed, or what have you, whatever, but there should be a certain amount of de novo analysis and review going on within the Commission on this kind of thing. I also think as far as public comment period, it's important for things that are happening in large volume to somehow periodically come to the fore from the public.

I think it would be very good if we had some sort of statistics, for example, of the scale of bona fide hedging exemptions, and of different types, including those that are being granted that are non- enumerated. And that would give a greater capacity for others to sort of say, hey, wait a second it's time to check into that one, and let's find out what's inside that category.

MR. McGONAGLE: Great. Thank you. I'm more mindful of time. I think unless there any further comments on this particular Panel, we'll close out this session this morning. My thanks to all of your feedback, we'll consider all the comments of course going forward. We are going to take a break for lunch and we'll start back up at 1 o'clock.

(Whereupon, at 12:06 p.m., a luncheon recess was taken.)

A F T E R N O ON S E S S I O N

(1:02 p.m.)

MR. McGONAGLE: Good afternoon. Welcome to the Third Panel. Thank you, our panelists, for coming today. Before we get started if I could just have the panelists briefly introduce themselves and we'll start with Terry Duffy from CME.

MR. DUFFY: I'm Terry Duffy, the Executive Chairman and President of the CME Group.

MR. JACKSON: Ben Jackson, President of ICE Futures U.S.

MR. CARLSON: Layne Carlson, MGEX.

MS. TOMALTY: Hi, I'm Sara Tomalty, Head of Trading Compliance for BG Group, but I'm here on behalf of Natural Gas Supply Association, a national trade association representing integrated and independent companies that produce and market 30 percent of the natural gas consumed in the United States.

MR. COTA: Sean Cota with the Petroleum Marketers Association of America and the New

England Fuel Institute and the Commodities Market Oversight Coalition.

MR. GALLAGHER: Good afternoon, I'm Ed Gallagher with Dairy Farmers of America and I'm also representing the National Council of Farmer Cooperatives and the National Milk Producers Federation.

MR. PROSSER: Good afternoon, I'm Ed Prosser. I'm the Vice President of Agricultural Trading for Gavailon LLC in Omaha, and I'm here to represent the National Grain and Feed Association.

MR. JESKE: My name is Jerry Jeske. I'm Chief Compliance Counsel for Mercuria Energy, a global energy end user.

MR. McGONAGLE: Great, thank you. Good afternoon everyone. So our third session today concerns spot month limits and the conditional exemption. The Commission's re- proposal would provide a conditional spot month limit exemption that allows traders who do not hold or control positions in the spot month physical delivery reference contract to acquire positions in the cash settled contract up to five times the spot month limit. Some commenters have suggested that a conditional spot month limit exemption equal to 125 percent of estimated deliverable supply may have the unintended consequence of draining liquidity for a physical delivery core reference futures contract. Other commenters have noted that market participants may be active in both physical delivery and cash settled commodity derivative contracts during the spot month.

And with that, we'll look to our first question on the Board, which is if the spot month limit on a physical delivery futures contract is updated in accordance with a reasonable deliverable supply estimate, would that increased level permit sufficient liquidity for bona fide hedgers, including in cash settled contracts? And if we can go to Terry Duffy from CME on that question.

MR. DUFFY: I will be happy to address that question; would like to make a couple of other comments if it's okay. When you're looking at taking a cash contract and giving it 5X, the position limits that's being settled off of a physically -- and priced off a physical delivery contract, I am very concerned about the liquidity in the price discovery contract. There's been many examples where people can look for higher head room to gain advantages for their own economic being. And what's critically important to me and everybody at CME Group is the credibility of our marketplace. I've been in the business for 35 years. I traded for 23 of those and there's nothing more important than the credibility of a market. And if you don't understand the viable pricing of that or if you think that pricing is skewed, I assure that will do nothing for the benefit of the farmers, ranchers and other producers in this country that rely on these products to mitigate their risks. So when you look to increase the position limits in a cash settled version of a physical contract, I think you're looking at no different dangers than you looked at when you had LIBOR. I think you're looking at dangers that are beyond what you can possibly control. When you're looking to fine somebody a half a billion dollars for fixing a trillion dollar market, now you're looking to encourage participants to go out of the price discovery market and put them into a higher headroom on a derivative of a derivative. Makes absolutely no sense to me and I think that we should be very cautious how you proceed in this because what's critically important is the people that rely on these products to do their price discovery, and do their risk management, and have the confidence that the consumer is going to have in the actual price of that product.

MR. McGONAGLE: So where do you see the balance between the cash settled and the physical contract? How can we draw this appropriate line?

MR. DUFFY: If you want to have a contract that's settled off cash, create an index to do so, and then if that position limit is different that would be one thing, but if it's being settled off of a physical you will do nothing more than siphon liquidity out of the price discovery market and put it into the cash settled market.

So we have a couple of examples at CME Group, one being lean hogs, one being feeder cattle that were originally physically delivered marketplaces. They ended up going to cash settled but there's proprietary indexes that were created with the industry to get the credibility of the pricing. The contracts that you're discussing, some of them are just lookalikes of a derivative, and I think that will be very damaging to the outcome.

MR. McGONAGLE: Ken in my ear is asking us if we can focus for a minute on the NG contract. And looking at current estimates of deliverable supply potentially for that a contract might have it at 15,000 for deliverable supply. Under the current proposal, if we applied 25 percent, that would increase the limit from 1,000 to just under 4,000, approximately. And so if we did that calculus today, does that alleviate or what's the CME sort of reaction to --

MR. DUFFY: The reaction to that, sir, would be that if in fact the cash settled version is the same as the physical we would not have a problem if the deliverable supply number was calculated to modern times. So if that's the -- if I'm answering your properly-- but I cannot harp enough about how you cannot have separate size position limits for the same exact contract especially when the other one is the price discovery. If you look at our NG contract, which is critically important here, over the last three years in a very low volatility period in the closing range, which is the last 30 minutes of a trading day of expiration, we've seen a decrease in our volume, in our physically settled contract, and an increase in ICE's contract which is cash settled. So even though we don't have perfect evidence today of data of what's going on we are starting to see a pattern that is very disturbing.

MR. McGONAGLE: Mr. Jackson from ICE?

MR. JACKSON: Thank you. So a couple of

comments on that. So first I'll take your question directly. ICE supports the looking at what is the deliverable supply today and revising those estimates and then making those estimates reflect changes in the futures contracts, the physically settled contract to the cash settled contract in lock step with the way the rules are in place today. We're 100 percent supportive of that. The main reason is, is that as a market operator today, one of my main responsibilities to my market participants is to make sure that we have futures contracts that do one thing and those futures contracts have to help facilitate the convergence of the futures price to the underlying physical product when it comes down into that final settlement period. And I highlight that because when we're talking about the gas contract specifically, the data points to -- and when I look across ICE futures U.S. Exchange which includes agricultural contracts as well as our U.S. energy complex, natural gas market and futures market is a model for convergence across any of the futures contracts that we have. All the data points to that. So number one we have a contract that works very well and it's the only contract where it has the conditional limit today.

Second thing I'd point out is that with the panel we had this morning and then the panel this afternoon we're talking about some new rules that are going to be coming in place. So when you have, yes the potential for deliverable supply going up, you have the potential for position limits going up, but at the same time with aggregation rules that are proposed, those aggregation rules, when you're aggregating positions across ICE, CME, and OTC markets are immediately going to halve that position. You also have more restrictive definitions around hedge exemptions. Another headwind that our market participants are going to see in certain contracts where we believe that if you have an increase in deliverable supply and more energy that's out there that needs to be hedged, coupled with headwinds of position aggregation rules that are coming in place, you put that confluence of issues on a contract that is the most successful contract there is in the futures marketplace right now at helping to facilitate that final convergence of the cash price to the physical, to me it is a dangerous combination.

As an operator of markets I believe in the Hippocratic oath and that's do no harm. We have a contract right now that works, it works very well, why change it. And from ICE's perspective we are a proponent and suggest the Commission build upon this success by applying this to other commodities.

MR. MCGONAGLE: I'm not following my own direction. If we could go to Sara and then to Ed. Thanks.

MS. TOMALTY: Thank you. I thought I'd chime in here because most of my comments are going to be related to natural gas given that we're a natural gas producer association. First I'd like to say we're not opposed to speculative position limits. We think that they serve a very important role in a well functioning market. However we do support CME and ICE's efforts to increase deliverable supply estimates. The estimates, as CME has stated, come from data that's from 1996. They also utilize data from BENTEK, which is a world leader in aggregating data, but the data they aggregate is based on what's public to FERC and FERC, as you know, regulates interstate pipelines. The data does not see intrastate and in-state production volumes, so I think they're missing a big piece of the market that I think CME and ICE can find when they revise their estimates.

In addition we support raising the deliverable supply estimate and that serving a basis for the futures delivery market limits, but even the revised levels are not likely to provide sufficient liquidity for our hedging needs in the cash settled market. An example of this that we're seeing currently in the market is when ICE converted futures to swaps and implemented position limits based on 25 percent of deliverable supply for all of the new converted cash settled contracts that are now futures. They're required by law to set them at 25 percent of deliverable supply. What we're seeing in the market and almost immediately after that happened was a lot of decreased liquidity. Producers have been unable to set hedges on ICE for the next winter because the bid-ask spreads are so wide. For example, in New England for next winter the bid-ask spreads have increased from about one to two cents to a dollar, so there's no transacting going on and we can't set hedges for next winter. In addition, we're seeing more frequent price run ups and downs with insufficient liquidity for market participants to get in and out of those positions. For example, both Tech Co. M2 and Transco Zone 6 non-New York have had significant price run ups this spring of a dollar and that was on less than one contract trading per day and some periods two weeks with no transactions. So we're seeing a lot of movement based on nothing happening in the market.

And finally energy companies are having difficulty setting marks at several locations for risk management purposes because there are no longer enough transactions to identify marks at certain trading locations. Therefore we see a need to increase deliverable supply to set the basis for the futures limit, but we also see a need based on the examples we're seeing in the formerly swap market to have a higher cash settled limit that's not based on 25 percent deliverable supply.

MR. McGONAGLE: Ed Gallagher?

MR. GALLAGHER: You may find it odd that the dairy guy has something to say about gas but the livestock that support our members do produce a lot of methane so I thought I'd comment. My comment is in general and it's going to tie back to class three markets because we've got some challenges with the rule on class three, but there's some commonality relative to cash settled futures contracts and there's a little bit of a discriminatory process I think we have to work through. But in general I think in a lot of markets the common theme you will hear from me is everybody is a little different, they have their own unique issues and we have to figure out some way to address each of those and a one size fits all approach may not work across the board. And I am struck by the fact that when I look at most of the existing physically delivered contracts, they at this point have, instead of a 5X ability to do cash settled contracts, they have an infinite X. And so I think you folks would have some pretty good data since you've been collecting some of the swap data to be able to see what's the size of the swap market relative to a physical commodity and what impact if any it's having on the things that you're concerned about on convergence and other issues that you have concerns about.

MR. McGONAGLE: Sean Cota.

MR. COTA: I think you really need to take a look at what the fundamental point of these markets are, which is, from my perspective, particularly from our coalition's perspective, is to supply and purchase commodities. So when you talk about physical markets in particular and the 28 hard commodities that we're talking about, the physical deliverable becomes a real issue when you're calculating, whatever the number is. As the cash settled becomes a larger percentage of the total amount of the trading, they really become economically equivalent. And if the constraints on them are a lot less, the overhead expense is a lot less, people are going to naturally migrate to that. So the folks that like to --

MR. McGONAGLE: They're going to migrate away from the physical to the cash?

MR. COTA: Away from the physical to the cash. And if you're the large section of trading group, which is, you know, the high frequency traders, because commodities are where they like to play the most because there's the most uniformity in these contracts, what happens is that the physical contracts get diminished. So my argument is that if the limits are appropriately low and equivalent, whether it be cash settled or physical, that you may suddenly have a market that changes to supply differently. So for example, in the heating oil market, the heating oil market which is the one that I grew up with, the heating oil is the smallest part of that contract to the point where it's now no longer the contract, okay. It's now called that but it's really diesel. So if you were to have certain markets with -- if the limits were sufficiently low in those markets, you would find instead of having one price for the heating oil which set the price for jet fuel, set the price for diesel, depending upon the different points, you'd end up with more contracts for different supply points. Natural gas is one that supplied -- there's very little central supply in it. That's not in the incentive of financial players because they want to do the most volume in uniformity in contracts; they're going to have more liquidity in that. But if you're going to be actually delivering to a market in this great game of chicken where you have to decide whether you're going to actually supply it or take it or settle out that position prior, the folks that actually use these markets for their intended purpose, you need to reinforce that. So 25 percent of a market is still high. We have three wheat contracts as an example currently under the old regime. Generally their limits are lower. Those exchanges I think are somewhere between five and ten percent for their own limits and that they seem to have worked so far. So we're going to have much higher limits to start with, even at 25 percent. For one entity to own in an economically equivalent market 150 percent, if they did the max out of the combined market, to me just seems absurd.

MR. McGONAGLE: So concerns that you have are setting the position limit or -- sorry, the spot month limit even at 25 percent is being too high, and then separately with this multiplier. So if you have it in a situation where you could go zero up to 125 percent, that the 125 is too large. And so the concerns -- I just want to catch it -- is sort of similar or different from the CME's about the drain of liquidity away from the physical contract and where do we draw that line?

MR. COTA: I think there are two elements. One is that if you have a differential in the limits that you will drain liquidity out of the physical market into the cash settled market. I think the other element is, if the limits are lower, people are going to then migrate to other contracts. If you take a look at for the CME's Clearport, for example. If you're buying jet fuel in California, okay, it's the Long Beach jet fuel contract that's priced off from the heating oil. It trades, it doesn't trade a lot because everyone who wants to provide the most liquidity in that market wants to trade in the heating oil part of that contract because that's where the money is made. The rest is risk mitigation. So the more that you have these limits being really high for the very high volume ones, the less, in my opinion, the less flow that will go into those other markets that actually deliver to those specific markets.

MR. McGONAGLE: So let's go to Ed Prosser.

MR. PROSSER: Thank you. I'm going to limit my comments to the Ag enumerated because that's the space we play in. And I'd like to start by echoing Ben's comment, do no harm. These markets serve two great goals, convergence and price discovery. Convergence is difficult. In fact I was trying to think as everybody was talking, I've been in this space for about 30 years. I don't know any of the Ag commodity markets that in that time that we haven't totally changed the delivery process. Terry mentioned cattle and hogs, both went cash delivery. The corn and bean contract changed to river delivery in '98. Recently we changed Kansas City and Chicago wheat. We worked as an industry with our DCM to change the contracts fundamentally because convergence is such an overarching goal. This is a very delicate balance in the delivery of these physical commodities, time and space and weather.

I think that before we use arbitrary mathematical formulas to set spot month limits we need to go back to the tried and true method where the DCM, with the local knowledge of each one of the contracts and the overriding interest to make sure that that contract has integrity, because that's who comes to play in that market. We need to serve that purpose first. Everybody would like it to be as big as it can be, but the definition of what it can be needs to start with the DCM to say, "You know what, in our interest this is the size of the corral, so we can't take any more cattle than this. These are the size of our elevators, this is the all the grain we can put." But getting away from the DCM's unique involvement in that process I think would be a mistake.

MR. McGONAGLE: Jerry.

MR. JESKE: Well, I don't want to sound redundant but I agree with a lot of what Ed just mentioned. And the one thing that strikes me in terms of this 25 percent is historically where does 25 percent come from? I think maybe staff and the Commission might want to consider the origins of this arbitrary 25 percent. And as it relates to deliverable supply, I would say that the CME's numbers that they've offered up are rather conservative. Cushing, Oklahoma isn't what it used to be. The flow of oil in this country is a lot different than what it was historically because of the fracking. You ever go over the Bakken area at night, see how much natural gas is being flared off? It's substantial. So this concept of deliverable supply I think needs a little bit of attention. And hasn't been really something that to my knowledge has been focused on enough.

MR. McGONAGLE: So the calculation of deliverable supply, where should the Commission consider going?

MR. JESKE: Internationally. The Commission I believe should consider all aspects, what the concept of deliverable supply really is rather than fixing it to a hub because that's not how the market works. And I think we had a lot of commentary in the first panel about how one sets, you know, contracts. Interstate contracting, right, that's where these rules come from, from the statute which talks about not to encumber interstate commerce. Well, as Ed mentioned it's not broken; I don't know what we're trying to fix here. And if it's not broken I would encourage the Commission to be reserved about how they employ new regulations that are onerous on all the firms that are already used to a process with the DCMs and is working well. That's something that I would hope would be considered wholeheartedly.

MR. MCGONAGLE: Layne?

MR. CARLSON: Thank you. It's going to sound like a little bit of piling on but it's really reinforcing the comments that Ed and Jerry have already made and others on this panel, but I just want to start off too and say that MGEX appreciates the opportunity to attend and comment on the Commission's proposed rule making on limits for derivatives. But maybe quick background, MGEX was established over 130 years ago and we're a designated contract market, and we're a derivatives clearing organization. As such the Commission's proposed limits and proposed rule making are going to have a dramatic effect upon our marketplace and particularly our participants who trade from around the world. We have a little bit of a unique take, but again supporting what others have already commented on, the Ag commodities that have traded in our marketplace since 1881 and our most actively traded contract is Hard Red Spring Wheat, which is one of the 28 named core reference contracts identified by the CFTC in its proposal. The Hard Red Spring Wheat's physically settled contract, which means that the methodology that's proposed by the Commission to establish spot month limits, based on that 25 percent of the estimated deliverable supply, really doesn't take into account some of the variables that exist. Others have already mentioned global transportation, weather issues, supplies, all play a factor in here. Further there's no strong or consistent correlation between open interest or open positions entering a spot month and the actual deliveries that occur during a spot month. Likewise there's no strong or consistent correlation between this physical supply and the actual deliveries that occur during a spot month in our wheat contract. Therefore kind of establishing spot month limits based on a formulaic approach without a demonstrable or measureable benefit is not something that should be adopted for our market or for our wheat market in particular.

And I might also quickly add that the Commission's proposed formulaic approach to establish non spot month limits is even more problematic and is more likely to result in harm in our marketplace and harm legitimate trade activity. The primary reason that the Commission's proposal throws out 75 years of equality among position limits, among the 3 domestic wheat contracts including Kansas City, Hard Red Winter, and CME's Soft Winter. The proposal creates such a wide discrepancy of position limits that's more likely to inhibit spread activity among the three wheat contracts. Inter-market spread trading in wheat serves a valuable economic purpose. I think the prior two panels there's been a number of participants who have emphasized that already. And again position limits based on a formulaic approach without a demonstrable, measureable, or even likely improvement in the fundamental principle of price risk, price discovery, or risk management is not good for our marketplace, it's not economic sound policy.

I would say finally too that the issue equality among position limits in the three wheat contracts have been supported by a number of wheat industry Ag groups and organizations in comment letters already submitted to this Commission -- and I would urge the Commission to consider those in their final rule making.

MR. MCGONAGLE: So I segue to the next question about recommendations concerning a different methodology in lieu of the 25 percent.

I also note that Ed has his flag up, so, Ed.

MR. GALLAGHER: Thank you. Carrying out from the previous question leading into the next question. For class three, the spot month is a very short period of time of about five days at the end of each contract which trades monthly. And so it's really not a relevant issue for us in the class three markets as long as the single month limit is less than the spot month limit. You don't want to have that reversed because that will create an issue. What our issue is, is that they're too narrow, the limits that you've suggested. My interpretation of the rule is that we've got -- since we've got a cash settled futures contract and where others have a physical futures and a cash settled derivative, they've got basically X plus X, they've got 2X of a limit, we've only got 1X and that's too constraining for our market. Relative to again, to dairy, we're young, we're nurturing, it's growing. We've got concerns that if you -- there's no practical way in the class three futures market that whatever your limits are will impact price discovery because futures do not impact the cash price discovery mechanism. There's no concern over price discovery. It's impossible to corner a market using class three fluid because of its perishability. That for our market to err on the conservative side is more risky than to err on the liberal side. And we'll see over time, there will be markets like we haven't gotten into yet, but our nonfat dry milk market or our whey market, when they are first introduced, to have a set number -- so this gets into the second -- to have a set number of what something could be that is a base minimum, that it won't go below that number. And then if you want to have spot month or -- and our issue is all months combined, single months and all months combined limits -- if you want to have those numbers be based on some sort of a formula, but that the limits will never be any less than X, I think we'd be okay. And I do -- it was Jerry that brought up the notion that markets change, deliverable supplies change, and I think there can be some risk at them changing in a way or the perception of what is a deliverable supply change in a way that creates a problem if you are doing it only by formula and you don't have some minimum level, is lacking.

MR. MCGONAGLE: So now I'm wondering whether I jumped ahead a little bit too quickly because I wanted to go back and want to hear a little more about this interaction on the cash and the physical and the -- you know a calculation -- you know, it's not broken, don't fix it, drain the liquidity. So how can I -- and so this isn't to you because -- or maybe it is to you -- but in dealing with the 2X scenario how do we make sure that we're preserving market price integrity and the price discovery process while ensuring against manipulative behavior? And then sort of how do I get that balance between the cash and the physically settled contracts?

MR. DUFFY: If I may I think that you have to draw the difference on a derivative of a derivative. If you're looking to set deliverable supply for both cash settled products and physically settled contracts, update the deliverable supply, but the cash settled contract has to be based on an index. It can't be priced off of the physical contract. And that's really where the rubber meets the road here where you're looking at manipulation, you're looking at all types of activity that's going to siphon out the liquidity. I can't harp on this enough; I said it in my opening remarks earlier. This is exactly what will happen. What's important is, what was said earlier down there at the end of the table, is that hedgers need to have the ability to hedge. There is hedge exemptions that are available but then you have to have somebody to take the opposite side of the market. So if you update the deliverable supply, you should be able to accommodate both sides of the trade. But at the same time, but give somebody five times larger position again on the conditional side that's based off of a physical market to me is asking for real trouble.

MR. MCGONAGLE: Where would you go -- what type of recommendation would you have on that relationship of one to one or zero to five?

MR. DUFFY: I would have it one-to-one obviously. I think one-to-one makes sense. I think it has worked. We could talk about the natural gas contract all we want. I think someone at the other end of the table said that these are 27 or 28 different products; they all should be treated a little bit differently. We're setting one example that's conditional today and I've already given you evidence that we're seeing a decrease in trading going into expiration of these contracts over the last three years. In a very low volatility period.

MR. MCGONAGLE: So whether as it applies to the other contracts a similar type of model as having a conditional exemption apply to other contracts?

MR. DUFFY: I don't believe there should be conditional exemptions for other contracts that are settled off of a physical market.

MR. MCGONAGLE: If I can go to Ben and then I'll go to Jerry. So just keep it at NG.

MR. DUFFY: I'm sorry?

MR. DANGER: I guess the question here was do you just want a condition limit one to one for NG --

MR. DUFFY: On all products.

MR. DANGER: On all products?

MR. DUFFY: No, on all products.

MR. DANGER: On all products?

MR. DUFFY: I don't -- but I think the NG decision was a bad decision and I don't know the basis for what it was and all of a sudden now it's being introduced into 28 other products which have nothing to do with NG so I'm still confused how it happened in NG to be honest with you. We didn't own NYMEX when that happened.

MR. JACKSON: So let me help there and let me address a couple of the comments that Terry made earlier as well. One, I was very confused by the connection between cash settled contracts and benchmark manipulation that was brought up earlier, especially coming from an exchange operator that has more cash settled contracts than -- so first that connection on benchmark manipulation I find interesting. The second is the data on natural gas liquidity and we've provided multiple sets of it and it says there's zero evidence that liquidity has been drained from the contracts. So I'd be very curious to see this information and this data for you to share that with all of us. We believe again what we have in place today works very well, it acknowledges the difference between financially settled contracts and physically settled contracts. I operate in a world as does Terry where we have both of those types of contracts. I'd be the first to say that physically settled contracts have a lot more risk associated to them, a lot more things that the exchange has to very acutely manage on a day-in and a day-out basis when it comes to those particular contracts, when you're going into the delivery process, when you're matching buyers and sellers, making sure that you have buyers and sellers that can actually take and make delivery, when you're dealing with third parties that are part of that ecosystem such as warehouse keepers for some of the contracts. There are a lot of different specific risks that those contracts have that are not present in cash settled benchmarks.

And just for a bit of the history lesson well, how did we get here? In 2010 the Commission required that each cash settled contract that referenced a physically settled contract, that the spot month position limits were a match and that they mirrored for all contracts, but in recognition of two things, one that cash settled contracts do represent a lower risk and they have little negative influence on the final settlement price of the physically settled future, combined with the fact that at that time a lot of the natural gas market was moving from OTC to futures. And a lot of that business was done in cash settled types of contracts that the Commission granted this conditional limit on the natural gas contract at that point in time. So we have four years of data all of which points to this has been incredibly successful and I'm complimenting Terry as having one of the most successfully physically delivered contracts with the best price convergence, 10 times better than what he sees in his corn, wheat, and soybeans futures contracts today.

MR. MCGONAGLE: So I don't want to create two panels here. If I can go to Jerry who's been so patient and then I'll come back to Mr. Duffy.

MR. JESKE: Well, Vince, in the interest of keeping the peace, we're a customer of both exchanges, so in terms of the conditional limit, we've availed ourselves of that conditional limit and the spot physically delivered contract is of course important. I think everybody here would agree that we want well functioning markets that are reliable, period. And I don't think there's any debate about that. Volume means something to the exchange. It means revenue source, right. Does it necessarily mean liquidity though? So let's not get that confused, because really the issue here is not to be so concerned about what liquidity or you want to call it volume -- let's be honest about it, call it volume -- is there more volume on ICE than there is on CME? That's really not the concern I think of the market participants. The concern is convergence and whether or not convergence operates properly. And I think Ed mentioned it earlier -- or there was a couple of mentions to wheat and I would like to bring to the panel's attention, particularly the Commissioner's, back in 2009 Professor Irwin, University of Illinois wrote I thought a very good study in connection with the wheat contract. There was a problem there. I think everybody should focus on that a little bit because that should be the fear. The fear shouldn't be if the volume numbers go through the roof at ICE or if they go through the roof at CME, that's a great thing; that would be fabulous. It's not a zero sum game. Everybody should be able to have the ability to contract freely, whether that's on ICE or CME, hedge their risk wherever they find it most appropriate. It's called business judgment. It should not be a --

MR. MCGONAGLE: So do you see convergence being affected by the conditional exemption?

MR. JESKE: I don't think so.

MR. MCGONAGLE: Anyone else want --

MR. JESKE: Again I point to the empirical evidence which I know of. In fact cash settlement was one of the potential solutions to the problem of the wheat contract if you'd read through the paper. That was an option. I think Ed mentioned that there was some fixing that went on in terms of the deliveries but I think, you know, going back to deliverable supply, going back to the fundamental commercial participants and where they take the commodity from point X to point Y through a delivery perspective. I mean I can talk about the energy market whether it's electricity or oil, but you're taking about the end consumer in the oil spectrum is going to be a refinery, right. So you need to look at it in that context. Electricity also needs to be looked at a little bit more closely. I think there's some confusion as to what does generation mean. Load is demand. That is not a factor of supply. Supply is generation. So I think the generation capacity that exists in this nation needs to be looked at a little bit more liberally or at least maybe more understanding. I'm sorry, Commissioner.

COMMISSIONER WETJEN: Just to jump in. Sorry, Jerry. You mention and I think Terry mentioned it before that two -- was it the feeder cattle and the hog contract at one point were physically settled, but no longer are, they're now cash settled. And presumably that was to address some kind of convergence issue? Terry?

MR. DUFFY: That was to address a lot of different issues. As you can realize in the hog industry the vertical integration that was going on, the captive supply concerns that were going on, the credibility of the pricing of how the price was being -- the contract was being delivered. You were no longer pricing the contract as a live contract, it was becoming a lean carcass and that's the way the industry was pricing it. So there's a whole host of reasons why that contract needed to be changed or it was going to go away and there would not be a price discovery vehicle for the hog producers of America.

On the feeders it was a very similar situation which happened many years ahead of the hog contract. So yes, that's the history of why those went that way. It wasn't for just purely convergence, it was because of the way the industry had switched.

MR. PROSSER: Commissioner, might I add thought that in each one of those instances there was a USDA referee index. That cash index is created independently of the trade. That is entirely different than a derivative off of a derivative when we allow one derivative market to set the settlement procedure for the other one. I do think those are two different issues.

MR. MCGONAGLE: Sara, where do we go?

MS. TOMALTY: While I like what Jerry said about volume not equaling liquidity, we use the swap market to hedge our huge exposure to Henry Hub. Global energy companies have exposures beyond the U.S. and so we need that market to be sufficiently large. Although we may have a hedge exemption we need more counter parties. So it's not just a volume issue, you need counter-parties in the market with which we can transact. So setting the limits higher, I think, promotes more liquidity based -- in terms of counter parties as well as volume.

You asked what risks are involved in the futures delivery market versus the cash settled market; we don't see the same risk involved in the cash settled market from having a limit at 1,000 contracts because -- well, we're actually promoting the futures delivery limit to be higher so we wouldn't want that to be at 1,000 contracts either. But with respect to the futures delivery market it actually goes to delivery so there is more risk of market manipulation. You know, you actually do have index manipulation, corners or squeezes, banging the close. I don't think you're going to see the same risks involved with the swap market where there's cash settlement.

MR. MCGONAGLE: We do have a trader question which is going into the spot month why would a trader be interested in having a large physical and a large cash position? I put that out to the broader panel but --

MS. TOMALTY: Oh, can I speak to it?

MR. MCGONAGLE: Absolutely.

MS. TOMALTY: As a global energy company we have a need to be in the physical market. Henry Hub is now a liquid market with a lot of different pipelines delivering to Henry Hub and there are going to be more pipelines proposed to deliver to Henry Hub. I think Cheniere is also adding. So we do have a need to be in the physical market. We are delivering to Henry Hub, we participate in the spot market, and often go to delivery. At the same time we have global exposure to Henry Hub so we have a need to be in the cash markets, cash settlement markets as well, to hedge our exposure. I think we would propose that you get rid of the obligation to not hold physical delivery position in order to have a five times limit in the cash market because I think you want energy companies speculating in the market. We transact based on fundamentals. You know, we are important to the speculative market to bring markets in line with fundamentals. I think it's a good thing for energy companies to have some flexibility to speculate as well as to hedge.

MR. MCGONAGLE: And where would you draw that line in terms of going from zero and five to what and what? I mean we're, you know, concerned -- let me say primarily concerned in the proposal that talks about the opportunity for manipulation or disruptive practices between these markets using one to leverage a result in another.

MS. TOMALTY: We support the cash settled limit being higher. Whether you do it 5X the deliverable supply limit or based on some open interest level. That's up to -- I think the exchanges are pretty well versed in figuring out what those levels should be. But, we do need, as I've mentioned, we need more flexibility, we need more counter-parties in those markets.

MR. MCGONAGLE: Yes?

MR. DUFFY: I support higher limits for cash settled contracts also, but not when they're settled against the physical. If you want to create an index like the gentleman down at the end of the table said, when we did create an index with all different products we worked with the industry to create one. We just didn't settle it off of an existing contract that's physically settled in the marketplace. I think that is a detriment to the users of the credibility of the price. Either get rid of the physical market totally and come up with a cash settled for everything if that's the way the market wants to go. It then gives no position limits because they're all dollars and who cares. We don't have to worry about it. But that's not the situation because you go down to the end of the table and you ask these folks if you want to have cash settled products and they go out to their user community they're going to say absolutely not. We need to have physically delivered products in order to keep the credibility, the buyability of that pricing for us to use throughout the industry.

So we should really break this apart and say if you want to talk about cash settled position limits is one thing, but they can't be based off of a physical market. It's just -- I don't even understand the concept of that. And as far as our cash settled business that we have done we created cash settlement at CME. We came up with the first cash settled contracts in the early '80s in our financial products with the industry, with the government. We worked with everybody to do this. But on other products it would be easier to go to cash settled and not have to worry about the delivery process. But that's not what the industry needs. So you have to work with what the industry needs.

MR. MCGONAGLE: Ed?

MR. GALLAGHER: We like cash settled products and not just in milk. We have some financially settled swaps in feed grains that are cash settled that we enjoy because we don't have to worry about anything to do with delivery in those positions. So there is a demand from some of us for some cash settled products.

MR. MCGONAGLE: In these questions that we've posed here today am I missing anything? What should we be focusing on? What questions should I be putting out to the panel? Jerry, you put your flag up first.

MR. JESKE: Well, I was just going to mention that optionality is important to commercial users. So I think the first panel concentrated on this to some degree. Whether you have some price exposure that you can hedge relative to a cash settled or a physically settled contract you need to have that outward optionality, you need to be able to do either. You can take the -- as was discussed earlier -- you can take a position in the futures contract that is ultimately physically settled in lieu of a contract with a bilateral party in the cash market, you have that flexibility. That flexibility shouldn't be curtailed, should exist. You have the ability to hedge cargos over the Atlantic in ICE and CME. They are going to come over to the Gulf coast and you want to have that flexibility. I always call it optionality but I don't want it to get confused with trade options because trade options is rather confusing. Since I've mentioned it, I wholeheartedly hope that trade options aren't part of this because it's undefined still. The seven part test is nobody's friend and, you know, I think that's mentioned earlier events in one of your questions so maybe that's one point that you might cover.

MR. MCGONAGLE: Agreed. I think I had skipped over that. Sean.

MR. COTA: I think the question that has

been mentioned that you need to ask is really how do you measure these markets for a physical deliverability. In the end I found that physical delivery markets have always performed ahead of everybody else, you know. My suppliers would shut me off quicker than a DCM would. DCM will always deliver the products. And if I don't have product I'm out of business. So even if you're financially cured later as is the case with say the Bear Stearns derivatives in some instances you're still out of business. So physical delivery is a key element of this and if the question is that these limits don't make sense then -- first there needs to be ratio. You need to reinforce the physical market as much as possible. I agree with Terry that if you don't think it has validity then get rid of the physical market altogether for that particular commodity. But as consumers we need these commodities to be delivered. If the market needs to be measured differently then measure it differently. But the ratios of one and a half times all that exists for a particular market to me doesn't make sense. And if you need reference points for a larger worldwide trading as Sara said, you know, they have real concerns. There may need to be a different sort of contract for that that doesn't exist now.

MR. MCGONAGLE: Ed.

MR. GALLAGHER: I wholeheartedly echo Jerry's comments on trade options. That would be a train wreck in the dairy industry if the trade option -- if a milk marketing contract that has some volumetric optionality, that in no way, shape or form was ever devised as a derivative becomes a swap, it could blow through position limits with just one contract. It would be a real problem with the dairy industry.

MR. MCGONAGLE: And so we're going to hang onto this topic maybe a little more. Ed?

MR. PROSSER: I just wanted to make one other comment about wheat contract equivalency. Applying this mathematical formula to each one of the markets has given the Commission to recommend that we increase wheat limits in Chicago. Incidentally we're going to raise Chicago's wheat limits above both Kansas City and Minneapolis. Does the Commission know that the physical market, its smallest production size is smallest in the United States is Soft Red Winter Wheat which is the wheat that's represented most closely to the Chicago market? So it gets back to this idea that 75 years of history and the local knowledge of the DCMs, I think, should be very well represented when we decide to set these limits.

MR. MCCONAGLE: Opportunity for closing comments, observations? All right. Thank you for a very exciting panel. I appreciate it. We're going to take a 15 minute break and we'll have our next panel on aggregation.

(Recess)

MR. MCGONAGLE: Welcome everyone to the fourth panel session today to discuss aggregation. And if I can have the panelists introduce themselves. We'll start with Ken Raisler.

MR. RAISLER: Thank you. Ken Raisler

with Sullivan & Cromwell on PEGCC, the Private Equity Growth Capital Council -- it's a mouthful there -- which is a trade association for private equity interests.

MR. MCCOY: Bill McCoy of Morgan Stanley and I'm here today on behalf of the Futures Industry Association.

MR. SWEENEY: Michael Sweeney, Sutherland Asbill on behalf of the Commercial Energy Working Group.

MR. NEVINS: Hi. Thanks for having me here today; it's Matt Nevins with the Asset Management Group of SIFMA. I work with our asset managers who manage mutual funds, private funds, and other client accounts including investments in these instruments.

MR. CERRIA: Hello, Chuck Cerria from Hess here on behalf of Commodity Markets Council.

MR. LASALA: Good afternoon, Tom LaSala, CME Group.

MR. WINDELER: Good afternoon, Curt Windeler, Director of Market Regulation, Intercontinental Exchange.

MR. PARSONS: Good afternoon, John Parsons, MIT.

MR. MCGONAGLE: Great. Thank you. So the fourth session today as I mentioned is a discussion on aggregation of positions. In circumstances where one firm owns an equity interest in another firm some commenters have suggested that the only relevant criteria for aggregation should be whether one firm controls the other and so focus -- what is the interaction between ownership and control as well as the availability of an exception are some of the questions that we're going to get into. To give us a little bit of an overview, though, we've asked Ken to talk about aggregation. Thanks.

MR. RAISLER: Thank you, Vince, and thank you, thank the Commission and the staff for organizing this roundtable and for the work that has been done to date in the aggregation space. Let me set the stage. I think and predict this panel might be a little less exciting or perhaps controversial than the last one. But nonetheless the issues are extremely important. I believe and predict there will be consensus on this panel to the first two issues that the Commission has raised and that is the issue of importance of control rather than ownership in evaluating the issue of aggregation. With proper separation between trading groups or trading units, we believe, and I believe the Commission has supported this in broad terms in the proposed rule makings, that that is the judgment that needs to be evaluated rather than the issue of ownership. If you look at the variety of business group structures whether they be one company with different business lines, parent- sub relationships, joint venture relationships, or as in the private equity space, private equity funds and portfolio companies, it is not the ownership issue that is the material issue to be evaluated. Instead it's the issue of who controls and how the separation of the trading activity can be assured to the satisfaction of the Commission and/or the exchanges. And that's historically been the case and we see growth in that area, both in the 10-50 where the ownership is between 10 and 50 percent and where the ownership is above 50 percent we don't believe materially that the evaluation should be significantly different. As long as there is the control separation, we're in the right place.

We believe and would recommend speaking on behalf of PEGCC, and I believe some members of the panel will have other specific issues with the rule makings as proposed, but we see three issues that we recommend clarification with respect to -- in order to put aggregation in the right place. As I said, I think we're going in the right direction. The first and most important is that in the above 50 percent category we don't believe it makes sense to have the Commission have to pre-review and approve each application. In the case of only the private equity space we believe there'd be literally thousands of such applications to be reviewed and instead we commend the Commission's approach in the 10 to 50 percent category of having a notice filing with the Commission. That's a critically important point both in terms of taking into account Commission resources but also providing certainty to the marketplace and avoiding an interim step of having to aggregate for a period of time.

The two other changes that we recommend are also important but not as important as the first one. One is that rather than having each board member of the owned entity make a representation -- and this is again in the 50 to above 50 category -- make a representation that they are not conflicted in terms of getting information. We believe that representation is more properly made at the owner entity level who of course controls those board members and otherwise is in a better position to make that representation. And then the last request would be that there is an unusual provision in the proposed rule about a penalty period of three months, a cooling off period of some kind. We believe that's inconsistent. If somebody is not in compliance with the aggregation rules as they're defined they would of course not be able to take advantage of disaggregation and would have to aggregate, but as long as they're in compliance they should be able to come back in without a cooling off period.

So those -- and I think those changes made, we would be in extremely good position, but broadly stated the focus here should be on control and not ownership. Thank you.

MR. MCGONAGLE: Thanks, Ken. So I wonder what -- probably makes sense to just wheel out to the other panelists to hear feedback on other particular items of interest or concern as Ken identifies at least on behalf of his clients on the above 50 percent category an ability to get a notice filing rather than having the Commission discretionary review. So I'll put out so I can see whether on this panel there are additional issues that we should be thinking about as we go through this discussion and the comment period.

Matt.

MR. NEVINS: Sure. Thanks again for having me here today and thanks for doing this panel; much appreciated, very important issue. So I'm just going to pick up where Ken left off and start out by saying from the asset management community's perspective here, we completely agree that the key fundamental determinate of aggregation should be trading control as opposed to ownership. We think ownership generally should not be a relevant factor in making the determination as to which positions get aggregated. From the asset manager's view this raises some very unique issues that I'd like to just sort of get into some of that detail on now. The first is that in addition to having an impact on the commodity derivative positions that they may put on for a fund or a client that they're managing positions for, asset managers would then be required to look at the equity ownership in the funds or the accounts that they're managing. In other words, if there is an ownership requirement that goes into the aggregation determination, they're going to need to look at the level of equity ownership that they have in an operating company. And if they're over the relevant threshold, whether it be 10 percent or 50 percent, then they are going to have to work with that operating company to figure out the positions that that operating company has on and get those positions taken into consideration with the positions that the manager itself is putting on for the fund or account that it's managing. We think that's completely inappropriate where the manager has absolutely no control over those positions that are being put on by the underlying operating companies. So again we think that that's an irrelevant part of the equation here. We think that the focus should maintain on trading control, on having the ability to select the individual positions that are being put on.

As far as the requirements related to making a notice filing or to perfect the exemption itself, we think that as proposed they'd be fairly onerous and burdensome. If we're talking about a situation where ownership of equity, so ownership of positions is not a relevant factor, then a notice filing would seem to us to be more appropriate. If ownership of equity positions as opposed to ownership of a trading account is part of the factor that means -- or is part of the factors that need to be taken into consideration, then it would require an asset manager to do due diligence of the positions that are held by that operating or portfolio company that they've invested in, coordinate with them to make sure that they're getting that information or having some other means of getting a data feed so they're able to either make the filing that's required to get an exemption or to actually take those positions into account and aggregate them in order to determine their own compliance with the rule. So I think generally speaking we'd be okay with a notice filing requirement if there was not an ownership component of the aggregation determination.

On the issues that are related to having a requirement for over 50 percent, I would agree with Ken that having to go back to the Commission and seek approval seems unworkable, especially for an investment manager who has to make trading decisions on a fairly nimble and quick basis in order to manage risk in their portfolios and manage the positions in their portfolios. So I would agree with the point that Commission approval should not be required even over 50 percent.

MR. MCGONAGLE: So just focusing for a second on this ownership question, if we consider taking away ownership and focused on control then the ownership set levels is de minimus, 10 percent, 10 to 50 there's certain considerations for control, and then 50 plus not just the Commission review but, you know, compliance or application of not only the control standards set at 10 through 50 but additional enhanced standards to evaluate. So how do you see that process changing? What's important about the control analysis? Have we articulated in a proposal those elements that you think would be -- that gets at the concerns for aggregation just using a control evaluation?

MR. CERRIA: Hello, Vince. Yes, actually we think you've done a really good job in this most recent proposal. I don't think I'm going to give the full cites but there's really good nuggets throughout the proposal. I'm going to point to 150.4(b)(i), (b)(ii), and (b)(iii), okay, where you're looking at really the essence of whether the entities are separate, the degree of separateness, how differently they trade or how differently they go about their business, if they're independently run from a control standpoint, and the day-to-day trading standpoint which is an in the moment kind of thing, okay. So that you may have regardless of ownership a senior vice president or a CFO who has a high degree of interest in what's going on but his interest is at a very overarching high level and never really descends down to the trading day-to-day operations and you need to focus on the facts and circumstances there. And this really does need to be a facts and circumstances analysis, and I think you've hit on all of the correct factors in those sections that I've highlighted. So good job on that part of the proposal.

MR. MCGONAGLE: And then getting at that if there was a proposal that did not consider ownership at some level then what balance do you see for control?

MR. SWEENEY: Yeah, thanks, Vince. Where I draw the line would be the control test would be applied at the trading level. I mean, I think the thing that the Commission has to consider -- and I do agree with Chuck that the proposal is a good proposal -- that at the owner level, there's very little actual day-to-day business, at least in our experience working with energy companies, where there's the type of knowledge, there's obviously expertise in management and other people who can oversee a business, because they have corporate governance responsibilities and fiduciary responsibilities. But on a day-to-day basis they don't have the actual real time knowledge to control or direct the trading at the trading level. So if you were to structurally put something in you would want the test and the procedures to be at the trading level for the recognition that it's not controlled at the top level of the company. I think that's, at least in our experience, a fundamental premise. There's not a lot of folks that we are aware of -- even in various corporate structures. So we have clients who work with -- they're a single entity, they have multiple business units or platforms that trade within it, people that have separate subsidiaries that are owned. The trading decisions and the trading functions and the business dealings are done at that desk platform level, it's not controlled up top. So I think if you put it at the trading level to start with the recognition that the parent level or the owner level is not directing that and allow people to show that, at least block, create some sort of conduit protection for information sharing I think you start out at a better place.

MR. MCGONAGLE: Bill.

MR. MCCOY: Thank you. Yes, and FIA in its comment letter echoes some of the same ideas that with respect to common control over direction of trading should be the primary focus. And as we indicated, and as Michael has alluded to, there may be other functions, risk management functions where the access to the data may be appropriate so that -- for example credit functions and other corporate governance functions that are needed, compliance functions that need to be aware to protect the overall enterprise. But that, in terms of the direction of trading and positions, where there are appropriate information barriers, such that traders do not have access to the data of the other organizational entities, that's where I think one has to start in looking at segregation and therefore determination that they may not be aggregate.

MR. MCGONAGLE: So I want to go to Tom

in a second but I sort of want to pull together some of the comments starting with Ken. Our concern about sort of overwhelming the Commission resources, right, and so, you know, if 50 percent ownership let's assume that, you know, ownership is part of a recommendation, if 50 percent captures too much why, you know, not jettison 50 percent -- move that up and maybe that has a -- and then we're dealing with a smaller group. And what I'm getting at is, we haven't talked about this sort of the exception or the catch coming back around for substantially identical trading and who's going to have that burden to evaluate whether in this myriad of subsidiaries or shell companies or whatever that there's actually more connection between the trading activity than might first be known or recognized.

MR. RAISLER: Yeah, I mean I think, Vince, that PEGCC was of the view that at 50 percent you could create a different standard or an enhanced standard. Obviously, the rule as proposed would be that if you're above 50 percent you need to comply with the 10 to 50 requirements and then these additional requirements. Certainly PEGCC would not object to going from 10 to 100 and not making that draw line at 50. I think, though, the issue of evaluation, I really would think -- and I think Tom LaSala was about to speak to this and will when we call on him next -- that the exchanges historically have looked at that, have looked at trading in concert, have looked at accounts that seem to have very similar trading behaviors and, you know, when that has happened they have taken action and, presumably, so too could the Commission. But the presumption is that the notice filing would be a representation by the legal entity company, JV Affiliate whatever that they have in place, the kind of separations that are in 150.4(b)(ii) and that in so complying they're stuck with that and if they misrepresent that to the Commission of course there's the possibility of review and sanction of them.

MR. MCGONAGLE: So, Tom.

MR. LASALA: Thanks, Vince. I guess

I'll begin with the point about the ownership simply. I guess the background for my position is, I think you know for years NYMEX COMEX administered disaggregation I would say in compliance with 150.4 and in that context we didn't have a hard line, you know, drawn in the sand with 50 percent or a barometer, but it was control based. You know, looked at the structures of the organizations, what information was shared, where were people sitting, what assistants did they share, what technology did they potentially share. So we were looking for a distinct separation, where the separation is clear, is distinct. And also we would run trading in concert analysis. So we had that ability, we exercised that ability. And as Ken said, you know, where appropriate, we'd look at that today. So there's a thorough examination. I don't frankly see the real distinction whether someone is more than 50 percent or between 10 and 50 percent if in fact you're answering the questions about the separation identically, you're testing them the same. I'm not sure why we need to go to necessarily a higher standard. And, you know, certainly talk about that. But I guess I was open and receptive when I thought I heard you say maybe in support of what Ken introduced earlier that, you know, a notice filing, that something even beyond 50 percent might be appropriate. I guess the point I'll add to that is I would still have some concerns that maybe for Ken's clients that some of the requirements that kick in, the no consolidated balance sheet or the restriction to the 20 percent of the spec limit for the company that was owned, while that not might be a problem for some I think it will be a problem for others. In the context of the 20 percent it does seem arbitrary and frankly I'm not quite clear what the consolidated balance sheet really means if you've satisfied the full scope of the test.

MR. MCGONAGLE: So where would you make your recommendation?

MR. LASALA: I would make a recommendation that there be a notice filing with no restriction as to percentage. I would eliminate those last two criteria for an excess of 50 percent and I would advocate that the agency perform some type of testing in all instances. You will be getting data with the OCR to do trading in concert. You'll have that ability. We have that ability today. So I think that there should be some back testing. That back testing arguably could occur, you know, on some repeat level. I think just remind you -- and I know you're sensitive to this -- you know, you've got people notice filing when they're making representations to you and to us, they're subject to, you know, being disciplined if they are misrepresentations or if either of us detect, you know, basically inconsistency in those representations. I think people take those representations seriously and, you know, the extent that someone, you know, doesn't, they'll be sanctioned.

MR. MASSAD: Let me make sure I understand your points. You know a lot of this is looking for bright lines for us. We're obviously a Commission of limited resources. We don't have lots and lots of people to evaluate the facts and circumstances of every situation. In suggesting that we use control instead of ownership and in other areas of the law ownership is an indicia of control. In the securities area obviously a much lower ownership is an indicia of being an affiliate. So I'm trying to understand if you're arguing for this control and saying even, you know, even a 50 percent ownership should not be considered a bright line. Is that I guess because you think the policy purposes we're trying to serve here are different because it feels different than say how other areas of the law might operate, or maybe there are other areas of the law where you think a similar standard is used.

MR. RAISLER: I would emphasize that there is the percent standard which is sort of a de minimis standard below which there is no requirement. I think though that from a variety of perspectives the way in which companies and affiliated entities and portfolio companies and the like trade really has created between them and their sister/parent, whatever it is, a form of separation such that if they were to be aggregated or required to be aggregated it would fundamentally change their business model. And I think all that we're asking is that the Commission recognize the way these organizations are structured creates a formal separation that allows representation to be made. I think historically and the line of 50 percent would be, you could argue a higher standard because by definition if you own more than 50 percent of an entity you do have some element of control of its behavior and so you need perhaps a more affirmative representation as is provided in the above 50 percent category, that you're not in fact exercising certain authorities that you otherwise have; you're waiving those authorities. But I think the notion of allowing this to happen is actually not new as Tom indicated. Although not formalized in regulation, the proposals people have had have gone to the exchanges with respect to relief and the exchange has evaluated the separation and made that resource determination. So I don't think we're asking for some radical adjustment in that analysis.

MS. ADRIANCE: Just to kind of also have you address-- since what has been suggested by a number of people here that the focus should be on control not ownership, however the determination of control is made-- that the focus should be on control and not ownership. And I want to just pull in some -- if anyone can address the CEA, the language in CEA which does not just limit itself to focus on control. There is language there that the proposal was trying to address and so any feedback as to how the Commission should address because, you know, obviously we're going to have to address in any final rule making we're going to have to address that. What should we be doing?

MR. MCGONAGLE: So congratulations, Riva. I think you got almost everyone to turn up their chart. But if we can go to Bill and then I guess just straight down the line.

MR. MCCOY: Right. Well, I thought to try to bring this together I was thinking that we're focusing-- that we're talking about control and I think the discussion that as Tom mentioned among the different requirements or the above 50 percent one that many of the market participants may have difficulties with, and FIA has certainly highlighted it, is with respect to looking at the requirement of consolidation and financial statements under GAAP where, of course, that is the definition of control as are a number of other statutory provisions that control. But that's to some extent corporate control over the entity as opposed to where, I think the purpose of the statute, in this case with respect to the limits, is control over the decision making on the trading, on the positions, as opposed to general corporate control. And as I mentioned earlier one of the things FIA asked for is clarification regarding how, while there should be no sharing of data of access of information, among the separate affiliated entities, where one is seeing disaggregation with respect to the traders, the ones who are making the decisions in trading, that there may be risk managers, credit departments, compliance groups, et cetera, where some shared information needs to be in place because from a perspective of corporate control there needs to be the oversight, generally, of the enterprise. However, to the extent that the statute and the historical perspective that the Commission is taking and the exchanges have taken, of focusing on the control of decision making, I think that underscores why putting in this additional requirement of reliance on consolidation of financial statements seems ill placed.

MR. SWEENEY: Okay. A couple of thoughts. I agree with obviously with Ken and Bill's comments. Mine will be additive. I think in terms of when we talk about control and how you get there and ownership and indicia of control, I think if you're talking about enhanced standard applied to entities where ownership interest is over 50 percent, you know, similar to other rules proposed by the Commission there can be, you know, some type, in my view, of corporate delegation or corporate authorization to allow for that independent trading by the actual owned entity where they're specifically authorized to engage in that activity by the senior management. And that authorization would be given in the context that the owning entity would only maintain such minimal control as is consistent with their fiduciary or corporate governance responsibilities to diligently supervise the trader. I mean that's something to think about. And that would also be done in the context of other applicable legal obligations of the owning entity.

And then in terms of the statute, the Commission still has the discretion to use, you know, section 4a(a)(7) as, you know, to exempt from the statute certain activity. If you placed -- it can be used in concert with the additional controls if they're present. Just, you know, a thought. You know, something to think about.

MR. MCGONAGLE: Matt.

MR. NEVINS: Okay. Thanks. I'm going to try to add onto the comments of all of my fellow panelists up here. I agree with everything that's been said so far. Our comment letter in February went into great detail in explaining our view and the distinction between corporate control and trading control. I'm going to try and very briefly summarize here. I think the question that the Chairman asked is a very good one. I think you need to look at other regulations in order to gauge whether it's appropriate or what the appropriate level of control is in the context of position limits and position limit aggregation. So here you're concerned about potential manipulation in the market, large size in the commodities space to potentially take advantage of positions. I think in other contexts, in the SEC context on, you know, large trader and ownership reporting in the FTC and DOJ context with Hart-Scott-Rodino, it does make sense to look at corporate control and look at ownership levels for determining, you know, again using FTC and DOJ as an example, antitrust concerns for large acquisitions. Here, where you don't have a common controller over the positions in commodity derivatives itself, it doesn't make sense to me to require aggregation based solely on ownership. So in other words, if there is a division and a split between who has the ability to put those commodity positions into place between the investor and the investee company, it doesn't seem appropriate to say, okay, you're imputed to control those commodity derivatives positions in the market and therefore aggregate those positions for making a determination as to whether that parent level entity has the ability to manipulate the commodity derivatives market. Where there is a complete split between the power to put those positions in place, I think ownership is much less of a relevant consideration. In fact, it's probably an irrelevant consideration.

The other thing I'd say just adding onto my fellow colleagues here, on the over 50 percent threshold, we also agree that accounting consolidation is a red herring here. The accounting rules require a consolidation from time to time even where ownership levels are slight. There are, you know, accounting considerations as to why an entity may be required to be consolidated on the books, on the balance sheets, so you have the liabilities and assets shown together in one place where there really is no other control. And I think that in order to make an exemption contingent upon accounting considerations also does not seem appropriate here.

MR. MCGONAGLE: So would you recommend an analysis of control just of the factors that we've outlined at the 10 to 50 percent level and not the additional factors, or where do you -- do you have a line drawn there?

MR. NEVINS: I would focus completely on control without looking at the ownership percentages.

MR. MCGONAGLE: Right. I guess what I was getting at is that there's different additional control factors at above the 50 percent and so if we marked away or walked away in some respect from ownership evaluation, what level of control analysis gets the job done?

MR. NEVINS: I'm sorry, Vince, I'm not sure I fully understand the question. But again I wouldn't make a distinction based on the percentage of ownership.

MR. MCGONAGLE: So I guess you're saying that for certain control evaluation there's outlined a number of factors including the accounting factor you set out.

MR. NEVINS: Right.

MR. MCGONAGLE: Which only comes into play at above 50 percent. And so what I was looking at was sort of the line drawn for control factors. I think we got -- Chuck had indicated earlier that he liked --

MR. NEVINS: I wouldn't have put accounting at all.

MR. DANGER: Yeah, let me just -- this is part of our learning about your thoughts. And I get that everybody seems to be not liking the ownership aspect of this whole thing and so my question would be what organizational difficulties do you face in complying with the proposed position limit rule regarding the ownership interest over 50 percent? So what are the organizational difficulties that you face in dealing with that? So, and that would help us understand what your troubles are in terms of complying.

MR. CERRIA: Thanks, Vince. Ken, before I get to that let me just finish up on what Vince was -- and I know Vince you were nodding to me here. And the one prong I think that I would recommend that I was talking about -- and I'll just read it out loud, "Procedures that are in place reasonably effective to protect coordinated trading decisions by such person." Okay. So that would be in the 150.4(b)(iii) or (ii). I had one too many "i" so it's (ii). Okay. So that answers that.

And, Ken, from an organization standpoint, I mean, one of the reasons that I wanted to come here today is because I have actually many years of experience at this before the divestitures of downstream at Hess where we had Hess Corporation in the business as an energy company, a fully integrated energy company, and we had Hess Energy Trading Company at the 50 percent level, it wasn't over, okay. And it still is actually, which is a worldwide trading company. And they are very separate and distinct; totally different corporate missions, like Ken alluded to a lot of the factors in his remarks a few minutes ago. And forcing them to share information -- and I want to note that when we're talking about this issue, we're talking about not only the futures positions or whatever, you know, whatever derivatives are going to be covered by the spot limits, we're talking about the associated physical positions, too, which is really the entirety of the business, okay. And so they just don't share -- they're set up purposely not to share information. They are separate and distinct. They have their own trading platforms, their own guidelines, risk management. There is overarching policies from a corporate governance standpoint, Mr. Chairman, where the enterprise is examined and -- I'm just telling you how we did it. It's only indicative of what we did. It's not something that I'm propagating for everybody. And so that level of oversight is -- I think I'm now famous for using altitudinal illusions. So that's a 50,000 footer, okay. And what we're talking about here is actually at the root level of day-to- day trading, okay.

And the other point I want to make is that these are intraday limits. So, I mean, we can't be -- I just physically don't think we can be aware of everything going on all over our -- everybody else's business all over the world through the day to make sure we don't bump up on a limit. And obviously I'm talking about at the last three trading days for energy. And, you know, and so being aware of all of that and differentiation about how at the moment a trader is making decisions is not a normal corporate process that other corporate departments are doing, you know. So a trader is a very localized, regionalized function that's happening right now. I mean there were comments made in the prior panel about how localized the decision is. It's a delicate balance of time, space, and weather. You know, all of these things are what's, you know, going on at the time of the trade right now.

And the last thing I want to offer to Riva's suggestion and even Mr. Chairman's suggestion with regard to resources -- and this is like out of the blue so take it for what it's worth. Earlier panels, the exchanges actually -- now they don't know I'm saying this so, Tom, don't hit me, but the exchanges offered to help you with an information sharing process before with the issues on the prior panel. Riva, if you want to associate a higher level of review because of ownership, because you feel indebted to the statue, maybe involving the exchange in that review or something would help. You would still make it effective upon notice so that, you know, we don't halt the business or retard the business, but, you know, the exchange has provided a very valuable function in this aggregation analysis through the last, you know, 15-20 years, absent before they harmonized with CBOT, and Tom will mention that; I'm confident he will. And we should defer back to that and rely on that. And it could be a way for you all to use the resources wisely. I think I'm done.

MR. MCGONAGLE: Tom, another person has put words in your mouth so let's see, where do you come out?

MR. LASALA: Vince, I think I was frankly a bit remiss before to you, the Chairman, the Commissioners and I didn't -- I left off probably a various essential component. I did not mean to be ignorant to the ownership criteria. And what I mean by that is, just to give you a little background in terms of structure, we primarily aggregate in the very first instance on ownership. So we're looking at that 10 percent, we're establishing groups in our systems, we're looking at the positions individually and across the group. So it would not be at all unusual for us to get a trigger of a prospective violation because we're aggregating across the group. So hypothetically, entities on the same side of the market trigger what might be, I'll say, a limit issue or an accountability concern. It is that that may lead to if it wasn't otherwise initiated, engagement with the participant that would have in the past or could lead to this detailed analysis of, you know, the control base structures and potential disaggregation. But even when we disaggregate we still have them, I'll call, "aggregated in a group" so we're still tracking the group of companies that have common ownership. So I think it's a very holistic, you know, I'll say, analysis as to the corporate structures. So again I did not want to infer before that I was ignorant or was throwing the ownership component out and I had left that out. So I apologize.

MR. MCGONAGLE: I appreciate that clarification, Tom.

MR. LASALA: Thank you.

MS. ADRIANCE: Yeah, as a follow up to that. It seems to me that what you're suggesting is that you think the better process is to use the tools that you are suggesting you have to, in a sense, allow -- when you've done a review-- to allow disaggregation but then to review, follow up and do a continuing oversight to make sure that that disaggregation was appropriate. So in a sense you're starting from the, okay we did the process, we determined that the control here is, you know, is enough. All of the factors for independence, it's reasonable to allow disaggregation but then -- so the approach would be let's allow the disaggregation when it seems to be appropriate, but we'll continue with our review and that's where we catch a problem rather than starting out from the other side of well, we can't allow it because there is an issue of possible control. So am I understanding that correctly? That you think you have the tools in place, you think the ability to go back and look and review, such that it wouldn't be an issue if there actually was identical trading strategies, if there was issues that came up?

MR. LASALA: I'll speak on behalf of CME Group. I believe we have those tools. I'll let Kurt speak on behalf of his organization.

MR. MCGONAGLE: Kurt, did you have something? And then we'll go to Ken.

MR. WINDELER: Yeah. Absolutely. And I apologize for everybody that thought there would be a more dynamic exchange between Tom and myself but we're largely in agreement with --

MR. LASALA: We've disappointed.

MR. WINDELER: Yeah, it's going to be quite dry. We largely do agree with what Tom has laid out, in that, look, ICE has a long history of engaging in the same practices that the CFTC, as well as other SROs, are engaging in on a daily basis and that is to surveil these markets, to adequately manage and administer an effective position limit monitoring regime that takes in this information, tries to analyze for that common control and independence or ownership factors every step of the way. To Tom's point, in clarification here, in fact ICE doesn't wholesale dismiss ownership. That is one of the first indications of a common trading strategy, a common aspect to a position that may need to be aggregated. And to the point that it's a "set it and forget it" type of situation, that's not the case whatsoever. Exchanges are actively engaged with participants from the onset of the initial large trader report to the identification of a 102, across markets, across contracts, across accounts we're looking at essentially those control and ownership structures. And to the extent that when we engage and have a discussion with a firm we go through, what I think the Commission has appropriately identified as, very good tests for independence in (b)(2)(i). Essentially those are the tests that we are looking for that's going to dismiss any further concern about ownership. And so we are in agreement that the additional tests for greater than 50 percent, they largely create a situation where it's not actually going to be something that a firm is likely going to be able to relieve itself of in terms of an exemption.

The last thing I'll say, since it seems to be a hot topic and a lot of people are chomping at the bit speak, is that I think that essentially in order to effectively surveil these markets not only does it require a lot of manpower, a lot of systems, a lot of administration, but it also requires a lot of coordination. And I think that's most appropriate to say that it needs some coordination between the SROs, but certainly with the Commission, because any indication or determination about aggregation that differs, that the Commission may make in regards to any sort of test or not for the federal limits that are being proposed, and the impacts on those markets, obviously dramatically impacts the surveillance that we're doing at the exchanges. And so I would suggest that not just having this bright line test as a good measure in good certainty in the industry, but beyond that, as far as the implementation goes that there's quite strong coordination between the surveillance groups to ensure that what that knowledge that is at the exchanges is shared with the Commission as well in what the Commission hears and understands from their conversations and interactions with the firms is shared appropriately.

MR. MCGONAGLE: All right. Thanks, Kurt. Before we go to Ken I did want to put out for people to think about, one question concerning questions or concerns surrounding how we've articulated the substantial identical trading strategy. I alluded to it earlier but I want to make sure that to the extent that there's comments about how we've articulated that as a process, that we get to hear what you have to say.

So, Ken, back to you.

MR. RAISLER: I'll defer to others on

that last question. But two points if I can picking up on Tom and Kurt. I appreciate as well that the Commission has had and continues to have a Form 40 and now the Form 40S, both of which ask the question do you -- you know ownership of more than 10 percent, either owning more than 10 percent or being owned more than 10 percent by others. So you have that data point consistent with the exchanges for purposes of evaluation. I did want to answer Ken's question about the 50 percent and the burden associated with that by illustrating that in the context as we did in our letter from the PEGCC. We have a situation where the PE funds may own dozens of companies. They may own up to 100 percent of those companies. Their ownership of those companies is effectively benign. They often times will put members of the PE fund or the PE parent on the board of these portfolio companies, but otherwise they don't get involved in the business of the portfolio companies and certainly don't coordinate or even are not knowledgeable about the trading at the portfolio company level. And so just imagine a scenario where you'd have to aggregate all of that information at the PE fund level and then allocate to the PE fund portfolio companies whatever headroom was available under a single limit or other similar situations. So the model for PE funds is uniquely ill suited to an aggregation regime and in fact completely inconsistent with the business model, which is, there is corporate ownership but there is no functional control over a whole variety of activities at the portfolio company level including, specifically, trading activities.

MR. MCGONAGLE: Bill.

MR. MCCOY: Yes, thanks. I thought I'd first address something further about operational difficulties and then if I may go to Vince your question regarding substantially identical trade strategies. So first just another scenario -- and I agree with what we've heard about a number of the difficulties of implementation, but another scenario I wanted to discuss is the presupposition

I think we've been talking about right now is where the corporate enterprise of many different affiliates, of various investments in portfolio companies is almost an ongoing concern state. But I wanted to address the difficulties in terms of acquisitions. So a new entity being acquired there is a host, as you know, or a myriad of types of issues one has to conduct in due diligence as part of that. And you could imagine as part of that a checklist that would include an understanding of the various types of positions that the target entity may have in terms of reference contracts if that entity owns interests in subsidiaries which owns interests in subsidiaries and then other interests, it gets that much more complicated. Add that to the fact that many of these cases, just the mere fact of the potential acquisition may be material non public information, so there's a very small group that is entitled to have the information prior to the public announcement of the acquisition. Now there may be time between that announcement and actual closing, but that time may be very compressed. So you can now foresee much of the operational difficulties of those that need to implement the calculations for aggregation doing so in a very short period of time after being permitted to be aware of that fact.

So one of the things that FIA had proposed in its letter to the extent that the rule does look at ownership at any level is to allow for essentially a safe harbor grace period whereby in doing -- and the FIA has asked for notice filing as opposed to approval, that a firm would be able to during that notice period, or a reasonable period, be able to submit the notice filing. And provided that they would be entitled to not aggregate the positions; the fact that they fail to provide the filing until that period of time has gone by would not work against them. And then further, should a firm fail to timely file a notice period, then that would be a violation a notice requirement. But it shouldn't equate to being a daily violation of position limits going back to the original date that the acquisition. So you can see how these operational difficulties of any type -- what one -- one important theme here would be that this rule making not somehow create implications on the capital markets and merger and acquisition type activity because of the difficulties of implementing and providing for the flow.

MR. MCGONAGLE: You would propose that we articulate in any aggregation that sort of the failure to make the filing is separate from -- would be separate from some underlying other violation?

MR. MCCOY: And just because one hasn't filed if one otherwise would be entitled to aggregation one should not then be deemed to be in violation of the position limit itself. So it would be whatever notice -- failure to file the notice that would have been required after the grace period to have gotten.

MR. MCGONAGLE: So I'll say I understand the point.

MR. MCCOY: Great. If I go to substantially identical trading strategies, the FIA in addressing this has noted that there is obviously here a lack of objective criteria, as there often is in rule making, and that will create its own challenges. One of the things though that the FIA pointed out in its letter, it's remembering first that the statute of course ties the concept of concerted trading activity to an express or implied agreement. And the FIA asked for clarification because just to show how one could, in FIA's view, misinterpret the scope of it, they pointed to example seven in the position limit proposal whereby this example seven of Appendix C of bona fide hedging positions where there was a -- I won't go into all the detail-- but a sovereign entering into a contract with a farmer whereby payments are made. And one can look at that bilateral contract and say looks very much like a swap. Okay, so that's a reference contract, fine. And then one reads through the example, it's discussing this in the context of what constitutes a bona fide hedging position and the example goes on to indicate where the two parties have entered into this bilateral contract and then the sovereign is the party that hedges its obligations using another reference contract, that the two parties -- one would read this as saying the two parties must solely as a result of that bilateral agreement must aggregate their positions. And the FIA has said in its letter and we have stated that we asked for clarification because this is not an agreement, just based on the facts that were presented. It's not an agreement by two parties to act in a concerted way of each entering into a trading strategy. The farmer, from his perspective, doesn't care if the sovereign is hedging its obligations. He just wants to know his price risk is being covered by that agreement. There's not an agreement between the parties to coordinate their individual trading. So it's a really good example in the rule as to where there are dangers if we don't have a clear understanding as to the type of criteria when we're talking about identical trading strategies.

MR. MCGONAGLE: Mike.

MR. SWEENEY: Yeah, I just want to touch base on a couple of operational considerations and go directly back to Ken's question. From the commercial energy perspective, a number of companies have taken efforts already to separate their trading operations. So you said what are the challenges of aggregating is you're going to have to undo that. Now there's certain companies that will have to remain separate due to other regulatory requirements and the rule addresses that. But from my perspective and I think from the working group's perspective, it's a much cleaner approach if you focus on independent control and having the right criteria established, worked out between the Commission and the market participants and the rule making process than to pull things back together for a couple of reasons. Chuck mentioned first a lot of the trading is regional and localized. So you can have in one context folks in Calgary, Houston, and in another part of the U.S. trading and then they may be trading the same derivative contract on-exchange, but what they're hedging in their particular physical portfolio are distinctly different and for distinctly different purposes. And they're not talking to each other; they're not aware on a real time basis what's going on. And if you force that aggregation then you create a scenario where you actually start to have to police those flows of information more than you would if they were actually independent and you ensure that they're -- you know, that the trading is independent.

Another scenario that comes up different than the one I just mentioned in the energy industry is that often times different parts of the business compete. They have distinctly different missions for what they do and the purpose they serve in the market and they can look at a position and have distinctly different views of how they would use -- you know, an opportunity to do physical business that then they will go and hedge, they have distinctly different strategies and views as to how they would go about it. And that information flow, if there is information flow, you're going to have to police that again so that is not used improperly.

So I think just one point, you know, what is the challenge? Well, you'd have to put something back together or put something together either you didn't have and the time and effort that would go into policing those flows of information. I think it's just a much cleaner approach, assuming people could satisfy your indicia, ultimately determined, is to keep things independent at the trading level. And then whatever is coordinated at the highest level could come up in a shared circumstance and be very contained. That's just a thought.

MR. DANGER: I'm just going to ask I think is the easy question, which is, I mean, aren't ICE and CME right now applying ownership perspective on aggregating futures positions right now? So they're doing this right now and somehow it seems to be working for everyone, okay. And so, you know, I'm thinking well what is the challenge here? So they're doing that in respect to energy contracts, Ag contracts, metals, and all that. I think, and maybe I don't completely understand so I'm looking for clarification on exactly what's --

MR. LASALA: I think, Ken, we are but by virtue of the current construct of our rules we're limited to where we can disaggregate to, you know, beyond 10 percent to eligible entities. So that is a constriction that, you know, again I think that Chuck would be a great example. You know, that restriction and other commercial entities that aren't eligible entities are completely locked out and they might say, you know, for all the good reasons that he made earlier -- you know, I have got no look into this group, we are so far apart, we share no systems, no people, no anything, yet now you've got me in a position where you're making me somehow try and coordinate what I do with this entity when in the normal course that's not at all what we'd do.

MR. MCGONAGLE: So just for structure here, so, Kurt -- we'll go Kurt, Chuck -- I know Matt's been patient but -- and also John. I want to make sure that we get to him. So we'll go Kurt and Chuck and then Matt and to John, yeah.

MR. WINDELER: Certainly. And I'll just clarify that in fact like I mentioned before we certainly do take ownership into consideration. That's essentially largely one of the first indicators to us that there needs to be an aggregation is you are aware the clearing firms or reporting firms are one of the front line indicators to us in the large trader reporting process to net and aggregate accounts by control in this special account as it comes across to us and identify it in a 102. And so ownership certainly is one of those indicators as we take a look beyond just what we're collecting in the large traders. We're looking at 102s, Form 40s in our discussions with the firms. But I think what we're trying to say here is that having a separate test based on a percentage of ownership that sets out different obligations for seeking exemptive relief is where I don't think that we're seeing the value in this process. If we've already established under (a)(1) that aggregation has to occur with greater than 10 percent ownership or control in that test we've already established that ownership is going to have a factor in it. It's just the additional tests when you get to a greater percentage that I think was what we're in disagreement with.

MR. MCGONAGLE: Chuck.

MR. CERRIA: Okay. Ken, before the divestiture of the downstream, we were subject to the new regime and it was very hard. Now you may not know how hard and it's kind of one the reasons I wanted to do this today because thank god we had no violations, okay, but there was a lot of angst going on behind the scenes at our shops trying to get information and stay within the limits when the spot month limit was going. It was very hard forcing this issue with two very dissimilar businesses who don't communicate, don't talk, and take umbrage at knowing that the other guy's got some position information. So I want that to be clear, okay. And that's really one of the driving forces that brought me here today to make sure that you all are clear that when there is true separateness and it truly is arms-length, you know, you really should respect that business judgment that was made by the entities.

MR. MCGONAGLE: Matt and then John.

MR. MR. NEVINS: Sure. So I'm going to pick up on something that Ken raised a little bit earlier. It struck a chord with me and that was the analogizing to Form 40 which I think is a good place to look. I think we at SIFMA AMG in our comment letters and others have made analogies to Form 40 as well. But I think it raises a very important distinction for the asset management industry and that's that there really is a difference between having a 10 percent control over -- or more over a trading account versus having a 10 percent or more ownership interest in an operating company. And then Ken followed up on this point as it relates to private equity funds but it's really even broader than that. It applies to registered funds, it applies to private funds that may not be private equity funds, and it applies to client accounts that asset managers manage that may not even be structured as a fund. But the Form 40, you know, requires reporting of a 10 percent or more interest for a reporting trader or the accounts of a reporting trader. I think that's again an important distinction. So when asset managers are filling out a Form 40 they're filling it out on behalf of the trading accounts that they own, they're not -- and, you know, looking to investments that may be in one of their funds, equity investments over a 10 percent threshold and then getting the commodity positions in the underlying operating company. Our concern is that the way that the proposal was worded could be construed to go beyond trading accounts and then require aggregation of interests in an operating company. And to the point that Chuck just made, and I think it's a very good one, that applies to operating companies as well as it applies to, you know, the fund business that where you don't have information sharing, naturally. Why would we wind up in a situation where let's say a fund manager then needs to try to figure out a way to go out and reach out to the operating businesses that their funds are investing in over a certain equity percentage to get those commodity positions. You're sort of incentivizing sharing of information, incentivizing, you know, potentially even working together where that otherwise wouldn't exist. So I would support Chuck's statement that separation should be maintained.

I think this follows over into some comments I have on substantially identical trading strategies. Vince, I know you wanted to go there; I don't want to monopolize the floor. I'll hold my comment for now if you'd like and can come back to that.

MR. MCGONAGLE: Go ahead.

MR. NEVINS: Okay, sure. So I think substantially identical trading strategies also raises unique issues for the asset management industry and I'm going to give you an example in the fund-of-funds context which has been a great concern for us. So I think we understand the purpose and the rationale behind why the Commission has proposed aggregating substantially identical trading strategies but it does not translate well to the fund industry. So you could have let's say a fund manager that manages a fund-of- funds which is a very common strategy in the registered fund space, it's a common strategy in the private funds space. And indeed for institutional clients they may have accounts that a manager manages and then invests in separate funds within that account. So if you're fund manager A and you have part of your portfolio -- let's say you manage an asset allocation fund-of-funds and part of that portfolio is going to be invested in physical commodity based funds, right. If two of those funds are deemed to be substantially identical trading strategies, right, then that fund manager may then need to aggregate all of the positions in each of those underlying funds if they invest their fund-of-funds into both of those substantially identical trading strategies funds. I'll try to crystallize that example a little bit better. Let's suppose you have a $1 billion, you know, mutual fund that allocates $1 million to commodity fund investing and then it takes $100,000 and invests it in, you know, commodity fund A and $100,000 and invests it in commodity fund B, and they happen to fall into the definition of substantially identical trading strategies. Then you'd have a $200,000 investment in a $1 billion fund that you as a fund manager potentially have to aggregate all of those positions in those underlying funds, fund A and fund B, up to your fund-of-funds manager and have that reported in one single aggregation position. That doesn't make any sense from an asset manager's perspective. It's something we're highly concerned about and we think that -- you know, it gets back to the ownership aggregation requirements as well as the substantial identical trading strategy aggregation requirements; that you need to think about the passive investor's perspective, whether it's a private equity fund and the issues that Ken raised earlier, or whether it's a registered fund, a private fund, or other client that an asset manager is investing on behalf of. It's a completely different set of circumstances. There is not acting in concert and they shouldn't require aggregation.

MR. MCGONAGLE: John.

MR. PARSONS: Yeah, so I just wanted to make one comment about some discussion that alarms me. I'm not sure if I really understand exactly what's going on. I think most of the indicia you folks have outlined are very relevant criteria. What alarmed me is discussions here -- I mean I understand when you have a parent corporation who owns two separate corporations, a railroad and an energy company and they don't really operate them together and so on as is discussed in some of the comment letters. I hear here conversation about trading desks and day-to-day trading strategies and the like, as if those can be fundamentally independent. And I find that very alarming. It seems to me if you have one energy company it may have a desk in Houston, it may have a desk in Stanford, Connecticut, but many of the indicia you described would be relevant. But to imagine that because day-to-day they operate independently somehow those positions should not be aggregated would be very alarming to me. It would seem to me to violate both what I understand are many ways in a company that strategies are tied together as well as the whole purpose of the limits here. Just to illustrate as an example, but it's only one, credit considerations certainly are going to come to bear for both of those desks no matter how they are operated day- to-day independently, they're going to come to bear when there are credit problems for the corporation as a whole and they're going to force common actions at those two separate desks and that will impact how the speculative positions then impact the market. And that's very relevant for the purposes for which this rule is here. And I just said I'm alarmed because from my experience with businesses those things are not really independent in a -- the way it's managed as a whole over a longer time frame and with the corporate structure as it is, makes it very relevant, the two separate desks being one position for the purposes of this rule.

MR. MCGONAGLE: We were talking about the -- from the traders going up and what responsibility do the owners have looking down. Chuck?

MR. CERRIA: Collecting my thoughts because I want to make sure I articulate correctly what I'm thinking and what the reality is so I can calm down John's alarming tendencies. So let me start with you mentioned credit, John, okay. And credit is one of those overarching corporate policy procedures and I guess policy that I was talking about before when I said corporate overarching policies and procedures are separate from the day-to-day trading that goes on, okay. And, yeah, we had credit policies in place that applies throughout the company and it actually applied to both the trading company and Hess Corporation. And so those policies are implemented though on a company-by-company basis and that is not really relevant to the positions that we take when we're hedging our -- or for whatever purpose we're doing on the futures exchanges in derivatives, okay. The trading is a day-to-day -- again corporate is up here, trading is right down here and, you know, it's not that a trader for the same company is ignorant of what's going on around, he's just not in the moment right now what's going on from an intraday standpoint across the world or even across the ocean. He's into his regional localized market and he's doing what he has to do. And so we need to understand the differences between overarching corporate procedures and in the moment trading right now to hedge a particular transaction that we need to cover for.

MR. MCGONAGLE: We'll go to Mike and then if they are just some final comments for the panel and then we'll close it out.

MR. SWEENEY: Okay. And I'll be quick. I think that, you know, John make a fair point, in the context of what we've been discussing when you -- if we're going to focus on control, standard trading level control versus ownership we're talking about an enhanced look that what is independent trading, lack of control. Some of the things that just the working group had put out and just worth reiterating for the record, if you're going to look at things, look at like, for tangible things, lack of common guarantors, is there a provision of independent credit. I think when you people have separately identifiable assets, I mean a business that is trading around -- for example Canadian crude production versus U.S. crude production, could have definitely -- you can look at it that way, because they're different assets, they're different risk profiles, they have different businesses. If you maintain separate lines of business, there's different products. You know, you may use the same derivatives but, you know, for certain things you may use natural gas for part, you know, hedging your power business, assuming cross commodity doesn't get you -- that was an attempt at humor -- but at the same time you're using natural gas for natural gas trading or other purposes. So you're keeping some of those additional criteria is really what we're talking about now I think or where the conversation has evolved is if you're going to allow disaggregation above 50 percent there's certainly going to be an enhanced set of criteria for the Commission-- I assume that would be applied if the Commission was going to consider it to allow this disaggregation. So as you think about that factor that those things, you know, sort of tangible things.

MR. MCGONAGLE: Thank you. Matt.

MR. NEVINS: Yeah, I just want to make a couple of additional comments that are related to the independent account controller exemption and some of the things we've talked about already today. So the first thing I'd say is that I think and we acknowledged this in our SIFMA AMG comment letter back in February that the Commission has moved in a positive direction in some elements of the rule proposal on aggregation, in particular including an independent account controller exemption back into the rule proposal we think is a positive way of proceeding. I also believe that including ways to disaggregate, if an ownership standard is going to be used, above those ownership thresholds is also appropriate. But as you've heard today from me and others there can be some improvements for sure, around -- if ownership remains a part of this thing -- around how you perfect those exemptions. As far as the independent account controller goes, again I commend the Commission for including that concept back into the new proposal, but we were a bit perplexed about why it was conditioned upon registration status as a CTA or CPO or a general partner in an exempt or excluded CPO as part of the test for the independent account controller exemption. So as you continue to consider how to move forward we think that is not an appropriate factor to be taken into account to perfect the independent account controller exemption. We think the other factors clearly make sense.

Getting back to the discussion from earlier, again I would stress that it is the ability to control trading that is key and fundamental in general in determining whether positions should be aggregated which again is why the independent account controller exemption makes sense and we think that that concept should be woven throughout the aggregation proposal in general, and also be followed in however you perfect your exemption requirements.

Lastly, as it relates to substantially identical trading strategies it struck us that you would be required to aggregate those substantially identical trading strategies even if you would otherwise be able to avail yourself of the independent account controller exemption. That's something that we also believe at SIFMA AMG does not make sense. So in other words if you have completely separate independent account controllers you have different advisors that are totally separate and making completely separate decisions and they have absolutely no commonality, no indicia of working together, why should their substantially identical trading strategies, however that's ultimately clarified and defined, why should those strategies be aggregated? That we have separate control, separate trading, those should remain separately allocated for and not aggregated.

MR. MCGONAGLE: So separate?

MR. NEVINS: You got it.

MR. MCGONAGLE: Do we have any final closing comments, remarks? Chuck?

MR. CERRIA: Thanks, Vince. I want to just mention one thing that I haven't mentioned, I don't think anybody's mentioned actually. And so, you know, there was a thought that when you come up with a rule and you promulgate it that you give the industry some time to comply before, so it will be effective, but there's a compliance period of maybe six months or something like that. I was going to ask for 15 years, but I think I'll go with 6 months, okay. Only kidding. But seriously that's the only other point I want to -- I think I -- I don't want to keep repeating everything.

MR. MCGONAGLE: All right.

MR. NEVINS: Thank you.

MR. MCGONAGLE: Thank you everybody. Thanks everyone for their participation. Staff will consider the comments going forward. This concludes the staff roundtable on position limits and aggregation.

(Whereupon, at 3:27 p.m., the PROCEEDINGS were adjourned.)

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CERTIFICATE OF NOTARY PUBLIC

DISTRICT OF COLUMBIA

I, Stephen K. Garland, notary public in and for the District of Columbia, do hereby certify that the forgoing PROCEEDING was duly recorded and thereafter reduced to print under my direction; that the witnesses were sworn to tell the truth under penalty of perjury; that said transcript is a true record of the testimony given by witnesses; that I am neither counsel for, related to, nor employed by any of the parties to the action in which this proceeding was called; and, furthermore, that I am not a relative or employee of any attorney or counsel employed by the parties hereto, nor financially or otherwise interested in the outcome of this action.

(Signature and Seal on File)

Notary Public, in and for the District of Columbia

My Commission Expires: May 31, 2018