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BARCLAYS GLOBAL INVESTORS

February 12, 2008

By electronic mail: secretary@cftc.gov

Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Attention: Office of the Secretariat

Re: Proposed Risk Management Exemption From Federal Speculative Position Limits

Ladies and Gentleman:

Barclays Global Investors N.A. and its affiliated asset management companies worldwide (collectively, "BGI") welcome the opportunity to comment on the Commodity Futures Trading Commission's ("Commission") captioned rule proposal, 72 Fed. Reg. 66097 (Nov. 27, 2007) (the "Rule Proposal"). BGI is a leading global manager of large institutional investment portfolios, including those of governmental pension plans, private pension plans, mutual funds, exchange-traded funds, separate accounts, bank-maintained group trusts, and common trust funds. BGI has over 2,900 institutional clients in 48 countries, with over $1.8 trillion in assets under management. As of December 31, 2007, BGI's total assets under management included more than $3.5 billion in futures strategies. As of such date, BGI had sponsored an additional $3.7 billion in commodity trusts. BGI affiliates also issue and assist in the promotion of iPath Exchange Traded Notes linked to certain commodity indices, the outstanding principal balance of which exceeded 3.1 billion as of December 31, 2007.

I. OVERVIEW

As the Commission is aware, in order to achieve portfolio diversification, to manage the volatility risk to which investment portfolios are subject, and to improve risk-adjusted returns, portfolio managers increasingly seek investment in asset classes that exhibit neither positive nor inverse correlation to traditional equity and fixed income assets. Investment research indicates that appropriately structured indices and baskets of physical commodities, including commodities for which the Commission establishes speculative position limits under Commission Rule 150.2, exhibit investment return characteristics that are uncorrelated with traditional portfolio asset categories.

As the Commission is also aware, for extremely large portfolios, existing speculative position limits, even as increased by prior Commission action, act as a constraint on the use of regulated futures contracts as a vehicle for obtaining the investment exposures necessary to achieve targeted levels of portfolio diversification through investment in commodities. As a result, portfolio managers are relegated to sub-optimal investment diversification or must turn to alternative, and potentially less efficient, instruments for obtaining targeted commodity exposures.

Based on the foregoing, BGI strongly supports the Rule Proposal. In light of the proposed risk management and related parameters for the proposed exemption, we do not believe that the Rule Proposal, if adopted, would adversely affect the futures markets or futures market participants. We have included in Section II immediately below some thoughts in relation to comments that have been submitted in response to the Rule Proposal. We have summarized in Section III a few comments on the Rule Proposal that are designed to assure that the proposed exemption accomplishes its intended objective.

II. RESPONSE TO COMMENTS

We note that a number of concerns have been identified by commenters on the Proposed Rule. Very generally, these may be summarized as follows:

- Institutional investment in the agricultural markets contributes to a lack of spot-futures convergence;
- Institutional investment in the agricultural markets contributes to abnormally high correlations across agricultural commodities;
- Institutional investment under the exemption would be equivalent to speculative investment because underlying investors are speculating; and
- Institutional investment in the agricultural markets contributes to increased volatility.

We believe these concerns are not supported by the relevant empirical data and reflect misapprehensions about the scope and operation of the proposed risk management exemption.

Convergence

At least one commenter has suggested that the agricultural futures markets have not exhibited an appropriate degree of price convergence in recent periods. Without any empirical support or analysis, the commenter implies that the lack of convergence may be attributable to or worsened by increased institutional investment in the agricultural futures markets.

We note preliminarily that one of the principal limitations on the scope of the proposed exemption is that exempt positions must be confined to non-spot months. There is no exemption for spot month positions. This is consistent with current portfolio diversification practices involving investment in non-correlated commodity assets. We also note that the nature of the exemption precludes market exposures that are increased in response to market factors such as shortages in supply. Given these restrictions, it is difficult to understand how institutional investment in these markets in accordance with the terms of the proposed exemption will contribute in any systematic and meaningful way to a reduction in convergence.

Correlation

At least one commenter has stated that certain agricultural commodities have exhibited increasing positive price correlation during the recent period of increased institutional investment, implying a causal relationship. If increased institutional investment in agricultural commodities is a cause of increased positive price correlation across agricultural commodities, then recent year on year increases in institutional investment assets under management in commodity index strategies should be associated with corresponding increases in agricultural commodity price correlations. Instead, however, empirical data from the second active contract for Chicago Board of Trade (CME) corn, wheat and soybeans indicates that correlations across these commodities were lower in 2006 and 2007 than they were in the period 2000-02 and were also lower in 2006 and 2007 than the rolling 5 year average. Assets under management in commodity index products have steadily increased year on year over this period. Accordingly, these data flatly contradict the assertion that increased institutional investment in agricultural commodities has been or would be a cause of higher inter-commodity price correlations.

Speculative Investment

A number of commenters have suggested that investments made under the proposed exemption would be equivalent to unrestrained speculative investment because investors invest in index funds for speculative purposes. We think this characterization is based on a misunderstanding of the exemption. First, commodity index investments must be unleveraged under the exemption. It is precisely the highly leveraged character of futures trading that gives rise to the potential for excessive speculation and the need for regulating mechanisms such as speculative position limits. Second, positions eligible for the exemption must be assumed for the purpose of achieving diversified exposure in the context of a broadly diversified portfolio. Accordingly, as we have noted elsewhere, such trading is not made based on supply and demand fundamentals or to profit from anticipated price trends or to take positions on the future prices of individual commodities. As a result, the impact of such institutional investment would not tend to track that of speculative investment. Third, the proposed exemption would retain all of the protections afforded by regulatory mechanisms such as orderly trading requirements, ability to mandate liquidation trading and the like.

Finally, and perhaps most significantly, the CFTC has permitted similar risk management position limit exemptions to operate in many commodities and for many years with no evidence that trading under such exemptions presents the risks of purely speculative trading.

Volatility

At least one commenter has stated that certain agricultural commodities have exhibited increasing volatility during the recent period of increasing institutional investment, implying a causal relationship. This is one of the more counter-intuitive assertions in the comment file for the Rule Proposal. Under the proposal, institutional investors relying on the proposed exemption would be required to track the composition of an index or basket. At least in the case of a portfolio diversification plan, index tracking would also need to track a prescribed weighting within the aggregate portfolio (see the discussion below in section III). As a result, as prices within the agricultural asset class tend to increase, targeted weighting will dictate a sale of that asset class to offset the increase in weighting attributable to increased prices. In a falling market, targeted weighting would dictate purchases to offset the decrease in weighting attributable to falling prices. As these scenarios indicate, the increased tracking of weighted index exposures should, if anything, dampen rather than increase volatility.

Two other points merit comment. One commenter, noting the current credit crisis, suggests, again without empirical support or analysis, that the Rule Proposal will exacerbate the financial pressures to which agriculture market participants are subject as a result of the credit crisis. While it is true that the credit crisis may adversely affect market participants on both sides of the agricultural commodity markets, the suggestion that the Rule Proposal will simultaneously have an adverse impact on market participants on both sides of these market (if it has any systematic impact) is incredible on its face. Even if one assumed that a predominance of long positions systematically increased spot-forward spreads, it is obvious that commercial participants who are natural shorts would, if anything, be benefited by that price impact. In any event, there is, clearly, no direct relationship between the credit crisis and position limits and it would be poor regulatory policy indeed to attempt to compensate for the effects of unrelated market dislocations by engineering artificial constraints on position limits – a blunt and ill-suited instrument for the purpose.

Finally, a theme that runs through more than one of the negative comments is the implication that the CFTC's regulatory policy – and position limit policy in particular - for these products should be informed solely or overwhelmingly by the needs of commercial hedgers. We believe this overstates the case. One of the principal tenets of the CEA is the recognition that speculative (but not excessive speculative) liquidity is critical to the successful operation of the futures markets. (As noted above, we believe that the terms of the Rule Proposal preclude excessive speculation by exempt institutional investors.) Separately, commercial hedgers are plainly not the only legitimately interested constituency when it comes to the regulation of agricultural and other physical commodities. Ordinary citizens, whose current and retirement incomes are significantly affected by physical commodity prices, have an equal stake in their ability to obtain asset management services designed to manage the corresponding risks to which their current and retirement savings are subject.

If, despite the foregoing discussion, the Commission retains any residual concerns regarding the potential implications of the Rule Proposal, we respectfully recommend that the Commission adopt (subject to the comments summarized in Section III immediately below) the proposed exemption on a 2 year pilot basis in order to afford the Commission an opportunity to review the relevant empirical data and make an informed judgment based on a rigorous analysis of that data, rather than on tendentious and unsupported characterizations of the relevant data.

III. SUMMARY OF RECOMMENDATIONS

1. Broadly diversified index

Under the Rule Proposal, a qualifying "broadly diversified index"[1] must not include a single component that exceeds 15% of the index weighting. We believe this standard is too restrictive and would unduly limit the use of existing indices that are capable of satisfying the portfolio diversification objectives of the Rule Proposal without unintended adverse consequences. The Commission's proposal to aggregate positions in certain commodity categories, such as wheat and the soybean complex, exacerbates the constraining impact of this limitation.

We acknowledge that it can be difficult to establish appropriate definitional parameters for distinguishing between baskets and indices, on the one hand, and their individual components on the other hand. Nonetheless we find the 15% proposal to be arbitrarily constraining and, as a result, counterproductive. Moreover, we believe that the Commodity Exchange Act ("CEA") currently incorporates Congressional guidance on this subject that the Commission should not simply ignore.

Specifically, the definition of "narrow-based index" introduced by the Commodity Futures Modernization Act establishes a standard that is designed to determine when it is appropriate to disregard regulatory restrictions applicable to an individual component of an index in light of the composition of the relevant index of which it is a component. As the Commission is aware, under that definition, if (among other criteria) an index has 9 or more components and no individual component represents more than 30% of the weighting of the index, the index is treated as a broad-based index and regulatory constraints that would otherwise apply to futures on the underlying components do not apply to futures on the index.

The Commission has indicated that the proposed limits are informed by observed positive price correlations between agricultural products, such as grains. We note, however, that the correlations across these commodities are not that dissimilar to the correlations across many securities within given industry sectors. The existence of these correlation levels, moreover, do not affect the 30% weighting limitation imposed under the CEA in the case of broad-based securities indices and should not do so in the instant case. If the Commission believed that the degree of positive price correlation for these products renders them potential surrogates for each other, for speculative position limit purposes, one would have expected the Commission to impose an aggregate speculative position limit for grain commodities as a class under Commission Rule 150.2. However, the Commission has not done so, and there is no empirical evidence of a need for the Commission to have done so. We therefore see no reason for the Commission to effectively impose such treatment in this context.

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[1] We note that the phrase "broadly diversified index" is not defined in the Rule Proposal. We recommend that the Commission consider giving somewhat greater clarity to this phrase.

As a practical matter, existing diversified indices include components that exceed or approach the proposed 15% limit.[2] These indices could easily, through rebalancing, fall afoul of the 15% limitation, with potentially significant adverse consequence for any fiduciary then tracking the relevant index in reliance on the proposed exemption. Finally, we note that the need for the proposed 15% limit is effectively obviated by the proposed overall limit of 50% on the weighting of all Rule 150.2 commodities combined.

2. Portfolio diversification plan

We agree with the Commission that tracking a broadly diversified index should qualify for the proposed exemption, as contemplated under prong (1) of the Commission's second condition for the proposed exemption (subject to our comments in section 1 above). However, we believe that the proposed "portfolio diversification plan" requirement should apply – without regard to the broadly diversified index test (but with regard to the other requirements of the proposed exemption) – in circumstances where a portfolio satisfies the following criteria:

- The portfolio comprises (or the combined portfolios of a person in the aggregate comprise):

  (1) investments in diversified portfolios of equities and fixed income instruments (and, optionally, other non-commodity asset categories); and

  (2) investments in commodities (including Rule 150.2 agricultural commodities); and

- The commodities component in clause (2):

  (3) tracks, on a consistent basis, a pre-specified weighting, index or basket of commodities; and[3]

  (4) exhibits, when measured over ten-year historical periods from the time of initial investment, less than forty (40 per cent positive or negative price correlation in relation to the portfolio(s) described in clause (1) above; and

  (5) consists of an aggregates exposure that constitutes no more than twenty percent in relation to the portfolio(s) as a whole.

We believe the foregoing criteria would establish the *bona fide* risk management character of the commodity investment strategy. In addition, the requirement that the

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[2] The S&P GSCI Non-Energy Index is an example of one such index. As of February 5, 2008, this index had 18 components, which included Wheat (17.24 %), Red Wheat (4.14%) and Corn (12.45%).

[3] We note that the 'tracking' of an index necessarily involves a certain element of execution discretion in terms of the timing of rebalancings, the timing of rolls and the selection of nearby contract months into which to roll positions. The Commission may wish to clarify that an index is passively tracked in circumstances where the fiduciary tracks the composition and weighting of individual index components, with execution discretion as to these factors.

commodity portfolio have, and consistently track, a pre-specified composition and weighting would ensure that trading in futures on Rule 150.2 agricultural commodities could not be used as a vehicle for evading position limits for speculative purposes. We therefore respectfully request that the Commission include these alternative criteria as an additional basis for exemption under Commission Rule 150.3.

3. Unleveraged position

As a condition to the exemption, the Commission has also required that the notional size of the exempted futures and futures-equivalent exposure not exceed the sum of certain assets including, in particular, "cash set aside . . . or unencumbered short term U.S. Treasury obligations." We believe this requirement unduly restricts the permissible scope of portfolio cash management activities. Portfolio managers commonly invest cash in a broad range of instruments, such as money market funds, short-term fixed income funds and similar cash management vehicles, as well as short-term fixed income instruments other than U.S. Treasuries. The precise character of these investments should be limited only by the investment objectives and parameters applicable to the relevant portfolio and the manager's fiduciary and contractual obligations. Moreover, in light of the fact that the purpose of this requirement is to ensure that the exempted futures and futures-equivalent exposure is unleveraged, we do not see any need for the Commission to impose significant substantive restrictions on the eligible short-term fixed income investments in which portfolio managers can invest funds for cash management purposes.

4. Portfolio managers

BGI agrees that a portfolio management exemption should be based on the characteristics of the investor's aggregate portfolio and the diversifying characteristics of the commodity exposure within the aggregate portfolio. As the Commission is aware, however, position limits apply both to persons who own and those who control large futures positions. Additionally, investment portfolios are commonly managed by multiple portfolio managers. As a result, it is possible that an individual portfolio manager will be responsible for implementing only a part of an overall portfolio management strategy. Indeed, it is possible that an individual portfolio manager may be responsible for implementing, for example, only the commodity (or a portion of the commodity) investment component of an aggregate portfolio management strategy.

In these circumstances, although the client's overall investment portfolio may satisfy the portfolio management parameters of the proposed rule, the portion of the portfolio for which an individual manager is responsible may not. However, in order for the Rule Proposal to achieve its intended objective, the exemption must be available both to the beneficial owner of the aggregate portfolio as well as the individual manager that manages the commodity futures exposure – even though the individual manager's activities – if viewed in isolation – would not satisfy the parameters of the proposed risk management exemption.

As a result, BGI recommends that the Commission clarify that, in circumstances where a client's aggregate portfolio satisfies the requirements for the proposed risk management exemption, any manager implementing the commodity futures component of the exposure will also be eligible for the exemption (with respect to that component). In addition, because an individual manager will not necessarily have direct knowledge of the composition of a client's aggregate portfolio, we respectfully request that the Commission clarify that an individual manager, absent knowledge to the contrary, be permitted to rely on a representation or confirmation from its client that the client's aggregate portfolio, taking into account the manager's investment activities, (1) exhibits the characteristics necessary for the individual portfolio manager's commodity futures positions to qualify for the proposed risk management exemption and (2) satisfies the "unleveraged position" requirement.

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We appreciate the opportunity to comment on the Rule Proposal. We applaud the Commission for its initiative and its continued focus on ensuring that the U.S. futures markets and its own regulatory framework continue to meet the evolving needs of U.S. investors. If you have any questions or would like further information regarding the foregoing, please do not hesitate to contact the undersigned at (tel. no. (415) 597-2620).

Very truly yours,

Barclays Global Investors, N.A.

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