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October 19, 1998

COMMENT

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

Re: Revision of Federal Speculative Position Limits and Associated Rules – Proposed Rulemaking

Dear Ms. Webb:

The Futures Industry Association ("FIA") is pleased to submit the following comments in response to the Notice of Proposed Rulemaking issued by the Commodity Futures Trading Commission (the "Commission") concerning Revision of Federal Speculative Position Limits and Associated Rules. 63 Fed. Reg. 38525 (July 17, 1998) (hereinafter sometimes referred to as the "CFTC Notice").

The FIA is a not-for-profit corporation which acts as a principal spokesman for the futures and options industry. Its members include approximately 70 of the largest futures commission merchants ("FCMs") in the United States. Among its associate members are representatives from virtually all other segments of the futures industry, both national and international. Reflecting the scope and diversity of its membership, FIA estimates that its members effect more than 80 percent of all customer transactions executed on United States contract markets.

The FIA commends the Commission for its desire to revise rules regarding speculative position limits to conform with recent developments in the futures market. In particular, FIA supports the increase in speculative position limits and the codification of the exemption pursuant to which Exchanges set position limits. FIA also supports many of the proposed changes to the Section 150 aggregation rules. However, the FIA does not support certain of the proposed rule changes because such changes are not necessitated by recent developments in the futures markets and current regulations offer ample protection in situations described in the CFTC Notice.

The FIA favors the amendment to the definition of "eligible entities" in Section 150.1(d) by expanding it to include a broader range of entities and their affiliates. With the recent consolidation of financial services companies, FIA agrees that the Section 150 exemption should be expanded to encompass a wider group of entities as set forth in the Notice except as noted in the penultimate paragraph of this letter regarding affiliates of FCMs. For clarity, FIA recommends that the phrase "separately incorporated affiliates" be modified slightly by changing it to "separately organized affiliates". This language change would clarify that the exemption applies to affiliates whether they are organized as corporations or not. For example, an affiliate may be organized as a partnership, business trust or limited liability business organization to achieve certain tax objectives. Under applicable law, any such entity would still have a separate identity, ownership and management structure and should be treated in the same manner as an affiliate which is organized as a corporation. Also, entities organized outside the United States may not technically be incorporated under local law but should be eligible as affiliates under the proposed revision as long as they are separately organized under applicable foreign law.

The Commission has proposed a significant change to the treatment of limited partners and other passive investors in a commodity pool which is not necessary because the current aggregation rules are sufficient to protect the commodity markets from undue accumulation of large speculative positions controlled by a single person or entity. Specifically, the proposed amendment to Section 150.4(c) requiring a limited partner or shareholder in a commodity pool to aggregate the pool's positions with the its own positions if the limited partner or shareholder has a 25% or greater ownership interest in the pool, or a 10% or greater ownership interest if the pool has 10 or fewer participants, should not be adopted for the following reasons.

This amendment is an unjustified departure from the current practice of focusing on "control" in determining whether relief from aggregation for independently traded accounts is warranted. CFTC Rule 150.3, which exempts from aggregation independently traded accounts, is based not on a limited partner's or shareholder's ownership of pool interests, but rather on the trading advisor's control of the pool positions. Moreover, limited partners and shareholders have been exempt from definitions of "ownership" in the aggregation requirements, beginning with the CFTC's predecessor agency, the Commodity Exchange Authority. See Notice at 38532; see also Rule 18.01; see also CFTC Statement of Aggregation Policy, June 13, 1979, CCH Commodity Futures Law Reporter, para 20,837 at page 23,426. The CFTC has not cited any instances in which the current regulatory approach failed by permitting a limited partner or other passive investor in a pool to exceed speculative position limits. FIA is not aware of any fundamental statutory changes relating to limited partners or shareholders rights which would merit the proposed change.

The impetus for the proposed amendment is the CFTC's generalized concerns about single-investor pools in which an investor contributes all or most of the pool's capital and is involved to some degree in the pool's trading decisions. CFTC Notice at 38532. The proposed amendment, by requiring aggregation for limited partners or other shareholders who have a 25% or greater interest in a pool or who have a 10% or greater interest in a pool with 10 or fewer limited partners or shareholders, without any inquiry into whether the investor is actually controlling or involved in the pool's trading decisions, is arbitrary and casts too wide a net. The FIA does not believe that subjecting passive, albeit substantial, pool investors to aggregation because they exceed these percentages will promote the policy rationale underlying the speculative position limits rules. The current aggregation rules for commodity pools and their passive investors are sufficient to protect the commodity markets from the undue accumulation of large speculative positions controlled by a single person or entity.

In response to the Commission inquiry as to whether the proposed levels are appropriate for reaching only unusual ownership forms (CFTC Notice at 38533), FIA does not believe that the levels of ownership proposed by the CFTC for such passive investors are the equivalent of "unusual or atypical arrangements" or "unusual ownership forms." FIA members believe that single investor pools are offered to investors because they provide substantial benefits. In particular, they eliminate certain administrative burdens relating to a managed futures account and afford limited liability to investors. To the extent that a pool includes provisions in its organizational documents granting some form of control by an investor over the pool's trading activities, the current regulatory structure is satisfactory for determining if aggegration is necessary under the specific circumstances. There is also no legal or factual basis for applying the specific percentages cited by the Commission as exercising a level of ownership which translates into control over trading. The fact that an investor may have a substantial interest in a pool does not mean that such investor has control over such pool's trading decisions. Most pools are established with the express purpose of retaining CTAs to make trading decisions pursuant to a trading system and without interference from investors. There is no basis to assume that by accepting few, but larger, investors in a pool, a CPO or CTA is prepared to cede control over its trading to such investors and permit its performance track record to be affected.

FIA's members are aware that many single investor pools, such as ERISA funds, are formed for reasons having nothing to do with the investor's desire to control or have input in the pool's trading decisions. Many such pools are formed to address the unique regulatory concerns that a larger pool faces or for other reasons, such as to maintain limited liability or to implement unique investment goals or fee structures. FIA believes that it would be premature for the Commission to modify its treatment of passive investors such as limited partners and shareholders until it has evidence that its current rules are not protecting the futures markets from participant's accumulation of positions in excess of speculative position limits.

The proposed amendment could also have harsh and unintended consequences for a passive pool investor. Without taking any action, an investor might find that its 20 percent interest becomes 25 percent after another investor redeems its interest in the pool. Under the proposed amendment, that remaining investor would now find itself subject to aggregation of positions even though nothing else changed in its relationship with the pool. The proposed amendment lacks any guidance as to how this type of situation would be addressed. Similary, this proposal would also place unnecessary burdens on an FCM to know whether an investor meets these percentage tests as percentages may vary due to redemptions or infusions of new capital by other limited partners.

In addition, it is not clear how a limited partner would be kept informed or even know about the extent of the positions that must be aggregated under the proposed amendment and take appropriate action to remain within the limits. Most CTAs consider their positions to be proprietary information from which their trading methodology or systems could be deduced and, accordingly, will not divulge such information to the investors in a pool. Most management agreements with CTAs contain express provisions to this effect. This problem would be exacerbated in the case of an investor such as a pension plan with substantial investments in more than one pool. Each time a contract becomes subject to spot position limits, that investor would be forced to aggregate 100 percent of the contracts from each such pool, determine if it remained below the limit and, if not, somehow force each pool to liquidate an appropriate number of positions. This is not a feasible course of action for such an investor and would discourage investment in the futures market. Similarly, most pools do not even provide trade information of the type and quantity of futures contracts traded by the CTA to a limited partner, even a single investor. How can this investor be in a position to aggregate positions not disclosed timely or at all.

The current aggregation rules for commodity pools and their passive investors are sufficient to protect the commodity markets from the undue accumulation of large speculative positions controlled by a single person or entity. The FIA is not aware of any situation in which speculative limits have been exceeded in the manner contemplated by the Commission. The current rules accurately reflect the prevailing reality that, as a general rule, limited partners and other passive investors do not control the trading decisions of the pool. Thus, under the current rules, mere ownership of a limited partnership interest in a pool is not a criterion for determining whether aggregation, or relief from aggregation, is required. Instead, control is the key criterion, which must be determined on a case-by-case basis. See Rules 18.01, 150.1 and 150.3. Rule 150.3, by the CFTC's own admission, "generally has worked well". CFTC Notice at 38531.

Under the current rules, limited partners or other investors that control or have input in a pool's trading decisions are required to aggregate all of the limited partner's positions with that of the pool's. Rule 150.1. FIA believes that pools with single investors or concentrated ownership present aggregation issues that are adequately addressed under the existing regulations.

For the reasons cited above, FIA believes that proposed Section 150.4(c)(1) is also not necessary. The mere fact that a 10 percent or more pool investor is also a principal or affiliate of the commodity pool operator does not lead to control over the trading of the pool so that aggregation is necessary. In large financial institutions, principals or affiliates may become passive investors in such a pool and this does not necessarily include any element of control. FIA is also concerned that this change would discourage financial services firms from investing funds in pools sponsored by their affiliates in seed money situations and this could stifle innovation in the futures markets. The current regulatory structure is adequate to provide protection where actual control exists. The CFTC has often recognized that the activities of affiliates in a large organization can be conducted completely independent from one another and this will be more prevalent following the consolidation trend in the financial services industry. Of particular concern is the fact that even with the relief for less than 10 percent ownership (notwithstanding common ownership/affiliation) aggregation is still required in the spot month pursuant to Rule 150.

Finally, the proposal to extend the Rule 150.3 exemption to, among other entities, the separately incorporated affiliates of an FCM, serves to create additional uncertainty. To avoid this problem, the 1979 Aggregation Policy, which is proposed to be adopted as Rule 150.4(d), should be extended to affiliates of the FCM and not limited to the FCM's independent traders. FIA believes that because Rule 150.4(d) requires a showing of independence, it is a preferable approach to clarify that the proposed rule includes affiliates of the FCM. In addition, we note that the Commission has already accepted this position in terms of affiliates of FCMs pursuant to CFTC Interpretive Letter No. 92-15. CCH Commodity Futures Law Reporter, 1990-1992 Transfer Binder, para 25831 at page 39,285. Proposed Rule 150.4(d) should be revised to specifically include affiliates of the FCM so it remains consistent with the Commission's current interpretation of the Aggregation Policy.

FIA appreciates the opportunity to submit these comments in response to the Commission's Notice of Proposed Rulemaking. If the Commission or any of its staff have any questions regarding this letter, please contact the undersigned at (202) 466-5460.

Very truly yours,

John Damgard
President
Futures Industry Association

cc: The Honorable Brooksley E. Born
The Honorable John E. Tull, Jr.
The Honorable Barbara P. Hollum
The Honorable David D. Spears
The Honorable James E. Newsome
I. Michael Greenberger