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Craig S. Donohue
Chief Executive Officer

June 16, 2009

**VIA ELECTRONIC MAIL**

COMMENT

David Stawick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581
secretary@cftc.gov

Re: Whether To Eliminate the Bona Fide Hedge Exemption for Certain Swap Dealers and Create a New Limited Risk Management Exemption from Speculative Position Limits – 74 Fed. Reg. 12282 (Mar. 24, 2009)

Dear Mr. Stawick:

CME Group Inc. ("CME Group"), on behalf of its four designated contracts markets ("DCMs"), appreciates the opportunity to comment on the Commodity Futures Trading Commission's (the "Commission") concept release on whether to eliminate the bona fide hedge exemption for certain swap dealers and create a new limited risk management exemption from speculative position limits (the "Concept Release").

CME Group was formed by the merger of Chicago Mercantile Exchange Holdings Inc. and CBOT Holdings Inc. in 2007, and subsequently merged with NYMEX Holdings, Inc. in 2008. CME Group is the parent of four DCMs: (1) the Chicago Mercantile Exchange ("CME"); (2) the Chicago Board of Trade ("CBOT"); (3) the New York Mercantile Exchange ("NYMEX"); and (4) the Commodity Exchange ("COMEX"). CME is also among the largest derivatives clearing organizations in the world. The CME Group exchanges serve the risk management needs of customers around the globe. As an international marketplace, the CME Group exchanges bring buyers and sellers together on the CME Globex electronic trading platform and on trading floors in Chicago and New York. The CME Group exchanges offer the widest range of benchmark products available across all major asset classes, including futures and options based on interest rates, equity indexes, foreign exchange, energy, emissions, agricultural commodities, metals, and alternative investment products such as weather and real estate.

## I. Background

### A. Exemptions for Bona Fide Hedging

Most physical delivery and some financial futures and option contracts are subject to speculative position limits. The Commission establishes Federal position limits for futures contracts on a specified group of agricultural commodities (*i.e.,* corn, oats, wheat, soybeans, soybean oil, soybean meal, and cotton), which are set forth in Commission Regulation 150.2.[1] For other commodities, exchanges determine the position limits or position accountability levels, pursuant to Core Principle 5 for DCMs in the Commodity

[1] 17 C.F.R. §150.2.

Exchange Act ("CEA").[2] With respect to CME Group exchanges, contracts subject to Federal position limits are listed on CBOT (*i.e.*, corn, oats, wheat, soybeans, soybean oil and soybean meal). Violations of Federal position limits are subject to enforcement action by the Commission and exchange disciplinary action. Violations of exchange-set position limits are subject to exchange disciplinary action and enforcement action by the Commission where it approved the exchange's speculative limit rules.

Exemptions from Federal position limits must be granted by both the Commission and the relevant exchanges, and are limited to "bona fide hedging." For products not subject to Federal limits, exchanges may also grant other types of exemptions from position limits, including but not limited to exemptions for risk management or arbitrage positions.

The general definition of "bona fide hedging" is in Commission Regulation 1.3(z)(1), which provides in part that "no transactions or positions will be classified as bona fide hedging...unless their purpose is to offset price risks incidental to commercial cash or spot operations and such positions are established and liquidated in an orderly manner in accordance with sound commercial practices...."[3] The second part of the definition lists various types of hedges which the Commission views as conforming to the general description in the first part of the definition.[4] The third part of the definition provides that, for purposes of exemptions from Federal position limits, the Commission may recognize hedges other than those enumerated in the second part of the definition as bona fide hedges.[5] To obtain a hedge exemption from the Commission, an applicant must, among other things, provide the Commission with evidence that the transactions or positions are consistent with the general definition of bona fide hedging in 1.3(z)(1).

The CME Group exchanges incorporate the Commission's definition of bona fide hedging into their rules,[6] and provide processes whereby persons seeking exemptions from exchange-set position limits may apply for exemptive relief.[7] In granting an exemption, the Commission or an exchange may impose any terms and conditions on the exemption that it deems appropriate. If a hedge exemption is granted, an exemption level is set at a specified quantity higher than the applicable speculative limit so as not to give a limitless exemption.[8] The Commission periodically reviews how each exchange grants exemptions from position limits, how the exchange monitors compliance with its limits, and what types of disciplinary action the exchange takes when a position limit or exemption is violated.

Certain commodity swap dealers and other market participants with swap exposure have applied for, and received, exemptions from position limits from the exchanges and/or the Commission. Swap dealers act as market makers in over-the-counter ("OTC") markets for clients that are seeking to hedge price risks as

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[2] "Position Limits or Accountability – To reduce the potential threat of market manipulation or congestion, especially during trading in the delivery month, the board of trade shall adopt position limitations or position accountability for speculators, where necessary and appropriate." 7 U.S.C. §7(d)(5).

[3] 17 C.F.R. §1.3(z)(1)(iii).

[4] 17 C.F.R. §1.3(z)(2).

[5] 17 C.F.R. §1.3(z)(3).

[6] CBOT Rule 559A; CME Rule 559A; NYMEX/COMEX Rule 9A.28.

[7] CBOT Rules 559 and 559F; CME Rules 559 and 559F; NYMEX/COMEX Rules 9A.29 and 9A.30.

[8] The Commission also sets a specified exemption level for those exemptions it grants in non-enumerated hedges under Regulation 1.3(z)(3).

well as for clients that are seeking to gain price exposure. "[F]utures market trades by swap dealers are essentially an amalgam of hedging and speculation by their clients. Thus, any particular trade that a swap dealer brings to the futures market may reflect information and decisions that originated with a hedger, a speculator, or some combination of both."[9] Hedge exemptions granted to swap dealers generally entail a number of restrictions, including that: (1) the futures positions must offset specific market price risk; (2) the dollar value of the futures positions must be no greater than the dollar value of the underlying risk; and (3) for agricultural commodities, the futures positions must not be carried into the delivery or "spot" month.[10]

### B. **The September 2008 Staff Report**

In September 2008, the Commission issued its *Staff Report on Commodity Swap Dealers and Index Traders with Commission Recommendations* (the "Staff Report" or the "Report"). The Staff Report contains information gathered pursuant to a special call issued to 32 swap dealers and commodity index funds requiring them to provide data relating to their activity in the futures and OTC markets. The special call (which was initiated in June 2008 and is ongoing) has required swap dealers to produce details of their bilateral, single-commodity swap business including, by market, the futures equivalent positions arising from swaps referenced to or hedged in a U.S. market, and in aggregate form, a classification of their single-commodity swap clients as commercial, noncommercial or intermediary. For these purposes, "commercial" means "a client/counterparty who has market risk arising from physical market activities in the subject commodity, and the swap agreement is part of a risk-management strategy"; "noncommercial" means "a counterparty who is not using the swap relative to physical market activities"; and the "intermediary" category "includes clients/counterparties that are intermediaries (other swap dealers, banks, etc.) for whom the [dealer] had no information on whether they are acting on behalf of noncommercial or commercial clients."[11]

The special call also has required swap dealers to identify clients whose aggregate OTC positions (measured in standardized futures contract equivalents) across all expirations in a commodity is at or above 25 percent of the single-month position limit or accountability level for the same commodity in the on-exchange futures market.[12] As the Staff Report explains:

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[9] *Staff Report on Commodity Swap Dealers and Index Traders with Commission Recommendations* (Sept. 2008) ("Staff Report"), p. 1.

[10] In addition to exemptions for bona fide hedging as defined in Regulation 1.3(z)(1), NYMEX grants exemptions in connection with exposure resulting from commodity swap transactions consistent with the Commission's Policy Statement Concerning Commodity Swap Transactions, 54 Fed. Reg. 30694 (July 21, 1989), or the Commission's Part 35 Regulations. These exemptions are provided for in NYMEX/COMEX Rule 9A.29 and apply to energy and metals contracts listed on NYMEX or COMEX. Exemptions in energy contracts are generally for the last three trading days as these contracts expire and go to physical delivery or, in the case of metals, are in effect for the pendency of the delivery month as these contracts generally deliver while still being available for trading (similar to certain agricultural contracts).

[11] Staff Report, p. 18, n.31.

[12] "Swap dealers were instructed to apply the 25 percent threshold as follows: add up all of the client's futures equivalent exposure gross long and short across all expiration months in a market, and then compare each of the gross long and gross short in that market to 25 percent of that market's single-month position limit or accountability level. For example, in NYMEX WTI crude oil, the single-month accountability level is 10,000 contracts net long or short and 25 percent of that is 2,500 contracts. If a dealer has a client that is equivalent to 1,000 long in the August future, 1,500 short in the September future, and 2,000 long in the October future, then their gross

> It is important to note that "positions" reported are not necessarily the same as futures and options positions held in the name of the client/counterparty. In the case of a swap dealer, the counterparty position may be offset against another OTC counterparty, offset through a non-U.S. exchange, or netted internally with other parts of the dealer's business.[13]

After receiving data from the special call, the Commission determined which of the clients identified by swap dealers were also identified in the Commission's large-trader reporting system and held concurrent futures or options positions in the same commodity. Outright futures equivalent positions (*i.e.*, futures plus futures-equivalent options) held in the trader's name were aggregated with the estimated OTC futures-equivalent positions attributed to the client by those responding to the special call.

Findings in the Report, based on Commissions staff's analysis of this data, contradict the notion that noncommercial traders rely on OTC markets to evade speculative position limits or accountability thresholds. Although a small number of noncommercial traders appeared to have an aggregate position (*i.e.*, on-exchange positions combined with OTC futures-equivalent positions) that would have been above a position limit or an exchange accountability level if all the positions had been on-exchange, the amount by which any trader appeared to exceed a limit or level was negligible in comparison to exchange open interest in the relevant market.[14] The Report shows, for example, that aggregate positions in West Texas Intermediate crude oil contracts that exceeded NYMEX accountability levels totaled just 25,000 long contracts and 15,300 short contracts out of total NYMEX open interest of 2.8 million contracts. The amounts by which CBOT speculative limits were exceeded in wheat, corn and soybeans also were negligible when compared to total open interest. These findings are consistent with numerous empirical studies that have shown that market fundamentals, rather than the activity of swap dealers or their clients, have been responsible for recent periods of increased volatility and/or price swings in commodity markets.[15]

One of the recommendations in the Staff Report was to review whether to eliminate the bona fide hedge exemption for swap dealers and replace it with a limited risk management exemption conditioned upon, among other things, an obligation to report to the Commission and applicable self regulatory organizations ("SROs") when noncommercial clients reach a certain position level, and/or to certify that none of the OTC swap positions of the dealer's noncommercial clients (in futures-contract equivalents) exceed position limits in related exchange-traded commodities. The Concept Release contains a list of questions designed to help inform the Commission's decision on this issue. As further explained in our responses to those questions below, CME Group believes that eliminating the bona fide hedge exemption for swap dealers, or otherwise further restricting their ability to obtain exemptions, is unnecessary and inappropriate and would be harmful to U.S. futures exchanges. We do, however, support the concept of continuing to require swap dealers to report the type of information described in the special call, which we

exposure (3,000 long and 1,500 short) meets the reporting criteria of 2,500 contracts, even though the position in any one futures month was less than 25 percent of the single-month accountability level." *Id.*, p. 19, n.33.

[13] *Id.*, p. 18, n.32.

[14] "These combined positions do not violate current law or regulations and the amounts by which each trader exceeded a limit or level were generally small." *Id.*, p. 5.

[15] Eight empirical studies reviewed by the Government Accountability Office ("GAO") "generally found limited statistical evidence of a causal relationship between speculation in the futures markets and changes in commodity prices—regardless of whether the studies focused on index traders, specifically, or speculators, generally." Letter from Orice Williams, GAO, to Hon. Collin Peterson, Chairman, House Committee on Agriculture, p. 5 (Jan. 30, 2009) (GAO-09-285R Commodity Indexes).

believe will enhance transparency with respect to trading that occurs in the OTC markets and assist the Commission and SROs in making appropriate regulatory and policy decisions.

II. CME Group's Responses to Questions in the Concept Release

A. **Response to Question 1**

*Should swap dealers no longer be allowed to qualify for exemption under the existing bona fide hedge definition?*

Swap dealers are legitimate hedgers that should continue to be allowed to qualify for an exemption from speculative position limits pursuant to the existing "bona fide hedging" definition. As the Staff Report explains, the products offered by swap dealers play an important role in the financial markets:

> [F]or many financial entities, the OTC derivatives products offered by swap dealers have distinct advantages relative to futures contracts. While futures markets offer a high degree of liquidity..., futures contracts are more standardized, meaning that they may not meet the exact needs of a hedger. Swaps, on the other hand, offer additional flexibility since the counterparties can tailor the terms of the contract to meet specific hedging needs.[16]

Swap dealers that assume risks in the OTC market, which are consistent with their legitimate businesses, should be able to transfer the residual market risk from their swap books to the futures markets under current standards for exemptive relief. Increased restrictions on swap dealers' ability to obtain hedge exemptions may cause two undesirable affects. First, limiting the hedge exemption for swap dealers could make it more costly for commercial enterprises to execute strategies in the OTC market to meet their hedging needs. Second, swap dealers may widen spreads in order to internalize risks or to attempt to hedge their risk through increased use of OTC instruments rather than exchange-traded futures. Both strategies undercut current efforts to reduce systemic risk by driving OTC-generated risk into a central counterparty clearing context.

Furthermore, existing rules presently allow the Commission and the exchanges to limit the hedge exemptions afforded to swap dealers (and other market participants) as deemed necessary and appropriate to protect the market. To the extent that swap dealers merit different treatment, it is effectively addressed by the ability of the Commission and the exchanges to impose conditions upon and restrict the size of any exemptions that they grant. For example, the Commission and CBOT presently condition swap-dealer exemptions for contracts with Federal position limits by including requirements that: (1) the futures position offset specific price risk; (2) the dollar value of the futures positions must not exceed the dollar value of the underlying risk; and (3) the futures position not be carried into the spot month.[17]

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[16] Staff Report, p. 11.

[17] *See* 74 Fed. Reg. 12284. Similarly, in granting no-action relief to index funds, Commission staff has imposed certain conditions, including requirements that: (1) fund positions are passively managed; (2) fund positions are unleveraged, so that financial conditions should not trigger rapid liquidations; and (3) fund positions are not carried into the delivery month, when physical delivery markets are most vulnerable to manipulation or congestion. CFTC Letter 06–09 (Apr. 19, 2006); CFTC Letter 06–19 (Sept. 6, 2006).

### B. **Response to Question 2**

*If so, should the Commission create a limited risk management exemption for swap dealers based upon the nature of their clients (e.g., being allowed an exemption to the extent a client is a traditional commercial hedger)?*

It would be impractical to base any exemption from position limits for swap dealers on the nature of the dealer's clients. The Staff Report explains that swap dealers do not use the futures markets to hedge price risk associated with specific swap clients or specific OTC transactions:

> Since swap dealers are willing to enter into swap contracts on either side of a market, at times they will enter into swaps that create offsetting exposures, reducing the swap dealer's overall market price risk associated with the firm's individual positions opposite its counterparties. Since it is unlikely, however, that a swap dealer could completely offset the market price risks associated with its swap business at all times, *dealers often enter the futures markets to offset the residual market price risk.*[18]

With respect to energy and metals markets in particular (which are subject to exchange-set position limits and accountability levels and are not subject to Federal limits), the Staff Report further observes that

> ...many swap dealers, in addition to their commodity index-related OTC activity, enter into other OTC derivative transactions in individual commodities, both with commercial firms hedging price risk and with speculators taking on price risk. In addition, some swap dealers are very actively engaged in commercial activity in the underlying cash market, such as physical merchandising or dealing activity. *The futures positions of these swap dealers represent a hedge of their net exposure, taking into account their overall long and short positions in various markets and derivative transactions. As a result, the overall futures positions held by these energy and metals traders in Commission-regulated exchanges do not necessarily correspond closely with their hedging of OTC commodity index transactions in particular.*[19]

Because swap dealers use the futures markets to hedge residual market risk in their swap books, particular futures positions of a dealer cannot be linked to a particular swap client or identified OTC transaction. Therefore, it would be illogical and unworkable to condition a risk management exemption for swap dealers on the dealers' ability to show that they are hedging risk arising from an OTC transaction with a client that is a traditional commercial hedger.

Furthermore, futures markets are used for more sophisticated hedging than "traditional" commercial hedging (*i.e.*, a substitute for transactions to be made or positions to be taken at a later time in a physical marketing channel). For example, electric utilities may hedge capacity risks associated with weather events by use of degree day unit futures contracts, although that hedge involves no substitute for a transaction in a physical marketing channel. Similarly, insurance companies may hedge hurricane or other weather risks. Enterprises that consume a commodity not used in a physical marketing channel, such as airlines that use jet fuel, generating facilities that use gas and produce electricity, freight

[18] Staff Report, p. 12 (emphasis added). *See also* Letter from Orice Williams, GAO, to Hon. Collin Peterson, Chairman, House Committee on Agriculture, p. 4 (Jan. 30, 2009) (GAO-09-285R Commodity Indexes) ("...swap dealers use futures to hedge their net exposure—the residual risk remaining after a dealer internally nets OTC swaps with offsetting exposures—and may not be able to untangle and identify the futures positions that are attributable specifically to commodity swap indexes").

[19] Staff Report, p. 48 (emphasis added).

companies whose loads depend on geographic pricing differentials and hundreds of other important examples that readily present themselves, are not traditional commercial hedgers with respect to such transactions. If the Commission were to create a new limited risk management exemption for swap dealers, it would have to ensure that it neither limits such commercial participants' ability to hedge legitimate commercial risk (either in the same commodity or a substantially related commodity) via a swap, nor limits swaps dealers' ability to hedge the residual financial exposure in their swap books.

### C. **Response to Question 3**

*If the bona fide hedge exemption were eliminated for swap dealers, and replaced with a new, limited risk management exemption, how should the new rules be applied to existing futures positions that no longer qualify for the new risk-management exemption?*

- *For example, should existing futures positions in excess of current Federal speculative position limits be grandfathered until the futures and option contract in which they are placed expire?*
- *Should swap dealers holding such position be given a time limit within which to bring their futures position into compliance with Federal speculative limits?*
- *Should swap dealers holding such positions be required to bring their futures positions into compliance with the Federal limits as of the effective date of the new rules?*

As explained above, we do not believe that a swap dealer's futures positions can be linked to a particular swap client or identified OTC transactions, which makes establishing a limited risk management exemption for swap dealers on that basis impractical. If the Commission nevertheless attempts to proceed along those lines, it must take into account that, although swap dealers generally carry their futures positions in liquid, nearby contracts, the risks they are hedging arise in part from OTC contracts that often extend out for a period of years. Swap dealers cannot simply close out those OTC positions when related futures contracts expire (which renders impractical the "grandfathering" option). Nor can they simply close out their OTC positions as of the effective date of any new risk management exemption rules (which renders impractical the third option listed in Question 3). Swap dealers should either be allowed to roll forward existing futures positions until their corresponding risk expires, or they should be given reasonable time to put in place alternative hedges and bring their futures positions into compliance with Federal limits.

### D. **Response to Question 4**

*The existing bona fide hedge exemptions granted by the Commission extend only to those agricultural commodities subject to Federal speculative position limits. Should the reinterpretation of bona fide hedging and any new limited risk management exemption extend to other physical commodities, such as energy and metals, which are subject to exchange position limits or position accountability rules?*

Exchanges are in the best position to understand their listed contracts and their customers' risk management needs, and to provide appropriate hedge, risk management or swap exemptions accordingly. The Commission's Core Principle 5 for DCMs requires boards of trade to adopt position limits or position accountability where necessary and appropriate, and the Commission, in evaluating a contract market's speculative limit program, considers the specified limit levels, aggregation policies, the types of exemptions allowed, and the methods for monitoring and enforcing compliance with the limits.

Additionally, all exchange rules governing positions limits and exemptions therefrom are certified to the Commission.

CME, CBOT, NYMEX and COMEX rules governing exemptions from position limits for bona fide hedging positions in physical commodities incorporate by reference the "bona fide hedging" definition in Regulation 1.3(z).[20] Thus, any revision to, or reinterpretation of, that definition would necessarily be reflected in these exchange rules.[21] Further, NYMEX/COMEX Rule 9A.29 governs exemptions in energy and metals for exposure in commodity swap transactions, and CME/CBOT Rule 559.B. governs risk management exemptions in products without Federal position limits.

Given the existing framework, it is unnecessary for the Commission to extend any reinterpretation of "bona fide hedging" or any new limited risk management exemption for swap dealers to other commodities. The Commission should continue to allow each exchange, subject to Commission oversight of its compliance with DCM Core Principles, to establish rules consistent with the objectives of reducing the potential threat of market manipulation or problems arising from excessively large speculative positions and facilitating orderly trading and expirations.

E. **Response to Question 5**

*If a new limited risk management exemption were to be permitted to the extent a swap dealer is taking on risk on behalf of commercial clients, how should the rules define what constitutes a commercial client?*

As explained above, we believe that swap dealers should be permitted to offset their residual risk in the futures market, and that it would be illogical and unworkable to condition any new risk management exemption for swap dealers on the nature of the dealers' clients. Nevertheless, if the Commission were to attempt to restrict a new risk management exemption to risk taken on by swap dealers on behalf of commercial clients, the term "commercial client" should be defined to include any customer that enters into a swap agreement for the purpose of reducing, controlling and/or redefining a risk incurred in the ordinary course of that customer's business. Futures markets are not used solely for "traditional" commercial hedging, but also for more sophisticated forms of commercial hedging that do not entail a substitute for a transaction in a physical marketing channel (*e.g.*, airlines hedging the price of jet fuel or insurance companies hedging risks associated with weather events). If a new risk management exemption is created for swap dealers, it must not limit such commercial participants' ability to hedge legitimate commercial risk (either in the same commodity or a substantially related commodity) via a swap, nor swaps dealers' ability to hedge the residual exposure in their swap books.

F. **Response to Question 7**

*For a swap dealer's noncommercial clients, should the rules distinguish between different classes of noncommercials—for example: (1) Clients who are speculators (e.g., a hedge fund); (2) clients who are index funds trading passively on behalf of many participants; and (3) clients who are intermediaries (e.g., another swap dealer trading on behalf of undisclosed clients, some of whom may be commercials)?*

Again, we do not believe that the hedge exemption for swap dealers can or should be based upon the commercial or noncommercial nature of the dealers' swap clients. However, for purposes of reporting by swap dealers when noncommercial clients reach a certain futures-equivalent position level (or certifying

[20] CBOT Rule 559A; CME Rule 559A; NYMEX/COMEX Rule 9A.28.

[21] Any revisions to these or other exchange rules, or any new rules adopted by an exchange with respect to exemptions from position limits, must be filed with the Commission as a certification filing, or as a voluntary request for Commission approval.

that none of their noncommercial clients exceed specified position limits in related exchange-regulated commodities), we see no benefit in distinguishing between different types of noncommercial clients, particularly if swap dealers provide regulators with the identity of such clients.

### G. **Response to Question 8**

*If a swap dealer were allowed an exemption for risk taken on against index-fund clients, how would the dealer satisfy the Commission that the fund is made up of many participants and is passively managed?*

- *Is certification by the dealer or fund sufficient or should the dealer or fund be required to identify the fund's largest clients?*

An efficient way for the Commission to confirm that an index fund is made up of many participants and is passively managed would be to review the fund's prospectus.

### H. **Response to Question 10**

*What futures equivalent position level should trigger the new limited risk management exemption reporting requirement? For example, under the rules of the on-going special call to swap dealers and index funds described earlier, a swap dealer must report any client in any individual month that exceeds 25% of the spot month limit, or the net long or short position of a client that in all months combined exceeds 25% of the all-months-combined limit.*

The Staff Report states that the 25-percent level specified in the ongoing special call "was set at a relatively low level in order to see more, rather than less, data."[22] We believe this is an appropriate level for a reporting requirement, particularly in light of the recent emphasis on obtaining better data on activities in OTC derivatives markets. The fact that swap dealers subject to the special call have established systems to report at the 25-percent level is an additional reason to maintain the reporting requirement for any new risk management exemption at that level.

### I. **Response to Question 11**

*If none of a swap dealer's clients exceed required reporting levels in a given commodity, or none of such clients exceed reporting levels in any commodity, what type of report should be filed with the Commission—e.g., a certification by the swap dealer to the Commission to that effect?*

Certification by the swap dealer should suffice, as supplemented by the Commission's special call authority to request books and records to audit on occasion.

### J. **Response to Question 12**

*Should there be an overall limit on a swap dealer's futures and option positions in any one market regardless of the commercial or noncommercial nature of their clients? For example, "A swap dealer may not hold an individual month or all-months-combined position in an agricultural commodity named in §150.2 in excess of 10% of the average combined futures and delta-adjusted option month-end open interest for the most recent calendar year."*

No "overall" position limits should be imposed on swap dealers who, as previously noted, generally hedge their net swap exposure acquired from trades with an amalgam of commercial and non-commercial

[22] Staff Report, p. 18.

clients. Swap dealers already must apply for and be granted an exemption in order to exceed position limits. Such exemptions are granted at the discretion of the exchanges and the Commission (in the case of products with Federal limits) and are subject to terms and conditions as the regulators deem appropriate to protect the integrity and orderly functioning of the market. NYMEX/COMEX Rule 9A.29, for example, specifies that one factor considered in establishing an appropriate exemption level is the "liquidity, depth and volume of the market in which the exemption is sought" and allows the regulatory staff "to modify, revoke or place limitations on the exemption" at any time. In addition, all exemptions are granted subject to a requirement that the participant initiate and liquidate positions in an orderly manner.

In those products for which single-month or all-months-combined position limits do not apply, exchange-set position accountability rules provide exchanges with the necessary tools to deter and prevent market manipulation and ensure fair and orderly trading. Monitoring the positions of large traders in each of our markets is a critical component of our market surveillance program. On a daily basis, exchange surveillance staff reviews large-trader data to monitor reportable positions in our markets. All participants with open positions that exceed set reporting levels as of close of business the prior day are reported, generally accounting for approximately 85% of all open positions through this process. Surveillance staff uses this data and various analytical tools to identify any positions that merit closer monitoring or intervention by regulatory staff.

Imposing single-month or all-months-combined limits on swap dealers, without exemptions, may cause clients of swap dealers to allocate business across a broader number of dealers without substantively changing the composition of the market. It will not, however, enhance the ability of the Commission or the exchanges to deter and prevent market manipulation and ensure fair and orderly trading.

### K. Response to Question 14

*How should the two index traders who have received no-action relief from Federal speculative position limits be treated under any new regulatory scheme as discussed herein?*

As explained above, we do not believe the Commission should create a limited risk management exemption for swap dealers that would attempt to look through the dealers to their clients. We support continued reporting requirements for dealers when aggregate OTC positions of a swap client (including but not limited to index funds) reach or exceed a specified level. However, this type of a reporting requirement should not affect the no-action relief the Commission has granted to certain index traders.

### L. Response to Question 15

*What information should be required in a swap dealer's application for a limited risk management exemption?*

Swap dealers seeking an exemption from position limits should be required to provide the same type of information to the Commission and the relevant exchange that they currently must provide to obtain hedge or similar exemptions. For those commodities with Federal limits, applicants must file an exemption request to the Commission in conformity with the requirements of Regulation 1.47.[23] The required information includes, among other things, detailed information "which will demonstrate that the purchases and sales are economically appropriate to the reduction of risk exposure attendant to the conduct and management of a commercial enterprise."[24]

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[23] 17 C.F.R. §1.47.

[24] 17 C.F.R. §1.47(b)(2).

In order to obtain a hedge exemption from CBOT for contracts with Federal limits, a swap dealer must complete a hedge exemption application, pursuant to CBOT Rule 559. The applicant must also provide: (a) the exemption request made to the Commission and the Commission's approval letter; (b) the notional value of the OTC instruments outstanding and, if the exemption is for anticipated exposure, the basis for the anticipatory request; (c) the prospectus of the relevant index, if required; (d) details of how the futures hedge will be initiated, rolled and liquidated; and (e) such supplemental information as the exchange may request regarding the positions or the underlying OTC exposure. The same type of information is required by all of the CME Group exchanges from swap dealers and other parties seeking exemptive relief related to swap exposure in those products that are not subject to Federal position limits.

## II. Conclusion

The CME Group exchanges support the Commission's efforts to continue to obtain the type of information about OTC transactions that swap dealers and index funds have been reporting pursuant to the Commission's ongoing special call. This type of information should assist the Commission and others in making appropriate regulatory and policy decisions. Existing rules, however, presently enable the Commission and the exchanges to limit the exemptions from position limits afforded to swap dealers (and other market participants) as necessary and appropriate to protect the market. We strongly believe that eliminating the bona fide hedge exemption for swap dealers, or otherwise further restricting their ability to obtain exemptions from Commission-set or exchange-set position limits, is unnecessary and inappropriate and would be detrimental to U.S. futures exchanges.

CME Group thanks the Commission for the opportunity to comment on this matter. We would be happy to discuss any of these issues with Commission staff. If you have any comments or questions, please feel free to contact me at (312) 930-8275 or Craig.Donohue@cmegroup.com; or Lisa Dunsky, Director and Associate General Counsel, at (312) 338-2483 or Lisa.Dunsky@cmegroup.com.

Sincerely,

Craig S. Donohue

Craig S. Donohue
Chief Executive Officer
CME Group Inc.

cc: Chairman Gary Gensler
Commissioner Michael Dunn
Commissioner Walter Lukken
Commissioner Bart Chilton
Commissioner Jill Sommers
Donald Heitman