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Sent: Wednesday, November 24, 2010 11:15 AM
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Subject: RE: Position limits comment letter
Attach: cftc.position.limits.comment.pdf

Subject: Pre-Rulemaking Position Limit Comments

Attached please find a comment letter on Pre-Rulemaking Position Limit Comments submitted by the Asset Management Group of the Securities Industry and Financial Markets Association.

Please feel free to contact me with any questions or comments.

Sincerely,

Tim Cameron

sifma
Invested in America

November 23, 2010

Mr. David A. Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington DC 20581

Re: Pre-Rulemaking Position Limit Comments

Dear Mr. Stawick:

The Asset Management Group (the "**AMG**") of the Securities Industry and Financial Markets Association ("**SIFMA**")[1] appreciates the opportunity to provide the Commodity Futures Trading Commission (the "**CFTC**" or the "**Commission**") with our comments and recommendations set forth below in advance of the issuance of any proposed rules relating to position limits under Section 737 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Dodd-Frank Act**"). The AMG supports the purposes set forth in the Dodd-Frank Act for setting position limits, when appropriate, namely to prevent market manipulation, ensure sufficient market liquidity for bona fide hedgers, and deter disruption to price discovery, including preventing price discovery from moving to foreign boards of trade ("**FBOTs**"). However, position limits established at too restrictive levels and without appropriate exclusions present the danger of unintended consequences and could, in fact, undermine the stated purposes. Indeed, Congress recognized that position limits, if set inappropriately, may adversely impact market liquidity, disrupt the price discovery function of the U.S. commodity markets and cause migration of trading activity to FBOTs. Position limits may not be an effective means of achieving the goals enumerated by Congress; instead these goals may be better addressed through other means, such as regulations specifically prohibiting manipulative trading activities, the advent of central clearing and other provisions under the Dodd-Frank Act.

With this background and as discussed in further detail below, the AMG respectfully requests that the Commission consider the following recommendations:

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[1] The Securities Industry and Financial Markets Association brings together the shared interests of more than 600 securities firms, banks and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry.

- While Section 737 of the Dodd-Frank Act sets forth time frames for adopting position limits, the AMG believes that the Commission is also required to make an appropriateness determination before establishing positions within these time frames. To make this determination, the AMG believes that data reporting mechanisms must be implemented and adequate market studies based on the reported data must be concluded. Short of this work being finalized, the AMG believes it would be more appropriate for the Commission to establish guidelines for how it will obtain sufficient information to support an "appropriateness" determination as to position limits rather than to adopt interim or final limits.

- The AMG respectfully requests that diversified, unleveraged investment funds and accounts that take passive, long-only positions, such as registered investment companies and ERISA funds and accounts, be granted an exemption from position limits under the Commission's authority pursuant to Section 737 of the Dodd-Frank Act. Such funds and accounts are long-term, stable, highly-regulated and low-risk liquidity providers that are not engaged in excessive speculation and do not trigger the enumerated concerns for which the Commodity Exchange Act ("**CEA**") permits position limits to be imposed.

- The AMG recommends that the Commission permit the disaggregation of separate funds and accounts (including registered investment companies and ERISA accounts), since each of these entities is a separate, distinct entity or series of a trust or company, established to meet a separate investment objective. In particular, registered investment companies and ERISA accounts do not, and under applicable law are not permitted to, engage in coordinated investment activity for any speculative or manipulative purpose.

- The AMG recommends that the Commission avoid an overly restrictive interpretation of "bona fide hedging". A narrow interpretation would hinder non-harmful, non-speculative activities that investment funds and accounts engage in, such as risk mitigation and investment hedging.

I. Background on the AMG members' interest in position limits regulations

The AMG's members represent U.S. asset management firms whose combined assets under management exceed $20 trillion. The clients of AMG member firms include, among others, registered investment companies, ERISA plans and state and local government pension funds, many of whom invest in commodity futures, options and swaps as part of their respective investment strategies. Many of the diversified, unleveraged funds and accounts that AMG members manage, such as mutual funds that generally track a commodity index (*e.g.*, the Dow Jones-UBS commodity index) and similar managed ERISA accounts, take passive, long-only positions.

Through these funds and accounts that track commodity indices, AMG members offer a convenient, well-established mechanism for individuals, pension funds, retirement plans and other investors to diversify their overall investment portfolios with exposure to the commodity markets. Commodities represent a very small portion of assets under management by AMG members (probably less than 5%). Nevertheless, commodities represent an important asset class to AMG's investors. In addition to managing funds that specialize in commodities-related investments, AMG members manage asset

allocation funds that invest in the commodity markets, thereby enabling investors to obtain exposure to an asset class other than equities and bonds within one balanced and diversified portfolio. Commodity-linked derivatives also allow prudently managed funds and accounts to mitigate economic risk, such as inflation and foreign exchange movements, and increase overall purchasing power.

Accordingly, members of the AMG have a strong interest in the proper functioning of commodity derivatives and commodities markets without undue restriction. The ability of AMG members to provide investor exposure to commodities through these funds and accounts will be directly affected by any position limit rules adopted by the Commission. Any rules that are overly restrictive could adversely affect not only AMG members and their clients, but also the U.S. commodity markets generally, potentially impairing price discovery and liquidity. In particular, restrictive limits could harm commodity producers and end-users who rely on these funds and accounts to take the other side of risk-protective trades and provide a stable pool of liquidity. As the Commission determines whether and at what levels to set position limits, the AMG respectfully submits that it consider the important portfolio diversification mechanism that AMG members provide to investors seeking diversified exposure to commodities, and the adverse impact that position limits may have on AMG members and their clients.

II. Notwithstanding the time frames contained in Section 737 of the Dodd-Frank Act, it would be premature to adopt position limits at this time.

Section 737 of the Dodd-Frank Act directs the Commission to establish position limits, *"as appropriate"*, within 180 days for exempt commodities and within 270 days for agricultural commodities, after the date of the enactment of the Dodd-Frank Act, and calls for position limits for economically equivalent swaps to be established simultaneously, *"as appropriate"*, under these deadlines.[2] Although the term *"as appropriate"* is not defined, a plain reading indicates that an appropriateness determination should first be made by the Commission before any limits are adopted, irrespective of the 180/270 day time periods.

A. Appropriateness Determination

In order to determine the appropriateness of any limits on any particular commodity futures or OTC derivative and the level of such limits, the AMG believes that thorough studies and analysis of the effects of position limits on liquidity, hedging and prices must first be conducted, giving due consideration to the enumerated purposes set forth under Section 737 of the Dodd-Frank Act.[3] However, the AMG questions whether adequate data to accurately establish and enforce limits is yet available. Importantly, although the CFTC has recently proposed rulemaking concerning the establishment of a position reporting system for physical commodity swaps and swaptions (the "**Large**

[2] Sections 4a(a)(2)(B) and 4a(5)(A) of the Commodity Exchange Act ("**CEA**").

[3] Specifically, the Commission must, "to the maximum extent practicable", use its discretion to establish limits to (i) diminish, eliminate or prevent excessive speculation; (ii) deter and prevent market manipulation, squeezes, and corners; (iii) ensure sufficient market liquidity for bona fide hedgers; and (iv) ensure that the price discovery function of the underlying market is not disrupted. Section 4a(a)(3)(B) of the CEA.

Trader Reporting proposal"),[4] a final rule will likely not be in effect, nor a reporting system established and sufficient data reported, within the 180-day time frame.[5] The AMG agrees with views expressed by Commissioners Sommers and O'Malia regarding the need to obtain adequate data before imposing position limits. As Commissioner Jill E. Sommers has noted, the Commission currently does not have complete data concerning open interests in each market, and will not have complete data until swap data repositories are in place and reporting data to the Commission, which will not likely occur until sometime in 2011.[6]

B. Unintended Consequences

Position limits imposed without the benefit of fully analyzing sufficient data concerning open interests in each market and the impact of limits on liquidity, bona fide hedging and prices could run counter to the appropriateness requirement and could result in unintended adverse consequences that the Commission is required to consider under the Dodd-Frank Act. Set inappropriately either as to timing of implementation or level, position limits could adversely affect the ability of bona fide hedgers, including commodity producers and end-users, to hedge and reduce risk; potentially increase volatility in commodity prices; and impair liquidity and price discovery of the U.S. commodity markets. In turn, these effects could inhibit legitimate business activities, such as new commodity production and exploration projects, causing supply distortions and thereby potentially leading to higher commodity (or other) prices. Commodity-related companies and end-users could also elect to undertake normal activities without hedging their risks due to limited market liquidity, thereby creating more risk in the marketplace. Additionally, one of the stated goals set for the Commission in Section 737 of the Dodd-Frank Act is to ensure that trading does not migrate to FBOTs.[7] Unless foreign jurisdictions are also coordinated and ready to apply comparable position limits, it would seem that for the Commission to impose position limits within the 180-day time frame would run counter to this mandate.

C. Substitute Products

Imposing inappropriate restrictive limits on the ability of funds and accounts to access commodity markets would cause investors to be severely restricted from engaging in a valuable asset allocation strategy. The AMG believes that investor alternatives to

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[4] *See* Position Reports for Physical Commodity Swaps, 75 FR 67258 (Nov. 2, 2010), available at http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2010-27538a.pdf.

[5] In addition, there are concerns regarding whether the reporting methodology of the Large Trader Reporting proposal will be adequate for purposes of establishing limits. *See* Commissioner Scott O'Malia, Opening Statement, Second Series Of Proposed Rulemakings Under The Dodd-Frank Act (Oct. 19, 2010), available at http://www.cftc.gov/PressRoom/SpeechesTestimony/omaliastatement101910.html ("I question whether we would be better off waiting until we build a solid foundation using complete and accurate data from the swap data repositories under a final ownership and control rule before we impose hard position limits on those contracts outside the most liquid swaps and futures contracts being traded today.").

[6] *See* Commissioner Jill E. Sommers, Concurring Statement Relating to the Commission's Proposal on Position Reports for Physical Commodity Swaps and Swaptions (Oct. 19, 2010), available at http://www.cftc.gov/pressroom/speechestestimony/sommersstatement101910.html.

[7] Section 4a(a)(2)(C) of the CEA.

investing in commodity derivatives are not completely adequate and could even exacerbate the problems that position limits are intended to prevent. Investment in commodity producer equities as an alternative simply does not provide pure exposure to commodities and subjects investors to risks inherent to the companies themselves and the equity markets. For example, investing in an oil company exposes the investor not merely to market moves in the price of oil, but more significantly to the risks attendant to the financial condition and overall management of the company. In the absence of being able to access the commodity derivatives markets, investors may instead seek exposure to funds that directly invest in, and hold stocks of, physical commodities rather than derivatives, and that are not subject to the CFTC's jurisdiction. These alternative funds are sometimes leveraged, resulting in tracking error to the price of commodities that they reference and creating more risk to investors. An increase in unregulated direct investment in physical commodities could result in far greater risk of price distortions and market impact on the U.S. commodity markets, particularly in delivery months.[8]

D. Interim Limits

As an alternative to establishing permanent position limits within the 180/270 day time frame, some commenters have suggested that the Commission impose interim limits.[9] However, the AMG believes that interim limits, if set at levels without the benefit of a true understanding of the open interests in each market and the impact of interim limits on liquidity, could also be disruptive to the normal functioning of markets, cause uncertainty and result in similar harms to investors and the commodity markets as the establishment of permanent limits. The AMG therefore respectfully submits that the Commission should take the time to fully study the need for and effects of limits rather than impose interim limits.

III. Diversified, unleveraged investment funds and accounts that take passive, long-only positions should be granted an exemption from position limits.

The AMG respectfully requests that diversified, unleveraged investment funds and accounts that take passive, long-only positions be granted an exemption from position limits under Section 4a(a)(7) of the CEA. Examples may include index funds, mutual funds that generally track an index (*e.g.,* the Dow Jones-UBS commodity index) and similarly managed public and private pension fund accounts. These types of funds and accounts are long-term, stable, highly-regulated and low-risk market liquidity providers that do not trigger the enumerated concerns position limits are intended to address.

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[8] *See* Craig Pirrong, *The Problems With Physical Commodity ETFs*, Seeking Alpha (Oct. 27, 2010), available at http://seekingalpha.com/article/232559-the-problems-with-physical-commodity-etfs ("There is a perverse irony here. The whole rationale (supposedly) for position limits is that speculation somehow distorts physical markets. There is precious little evidence . . . . that this is a real problem. But by driving those that want exposure to metals prices . . . regulations are making it *more* likely that speculation will distort prices and the physical markets.")

[9] *See, e.g.,* Futures Industry Association comment letter (Oct. 1, 2010), available at http://www.cftc.gov/ucm/groups/public/@swaps/documents/file/derivative26sub100310-email3.pdf.

A. Differentiating Traits

The AMG believes that the investment activity of such investment funds and accounts does not constitute excessive speculation and does not promote price manipulation. With respect to such investment funds and accounts (other than defined benefit pension plans), the amount of capital invested in their positions is largely controlled by individual investors coming into or out of the funds as opposed to the taking of active positions. For defined benefit plans, the amount of capital invested is determined by the plan sponsor or investment manager's desire to diversify or mitigate risk (*e.g.,* inflation or other investment risk). Position fluctuations typically occur in relatively modest percentage changes rather than large volatile shifts.

Diversified, unleveraged investment funds and accounts that take passive, long-only positions do not share any of the problematic characteristics of a fund like Amaranth Advisors LLC, which was five to eight times levered in its natural gas bets.[10] Unleveraged funds significantly reduce market pressure in the event of a forced liquidation of the fund, and are less likely to liquidate than funds that have less capital. These funds often utilize pre-determined rebalancing algorithms, which provide liquidity for commodities that have declined in value during a prior period and thus tend to offset price movements. Furthermore, these funds typically roll over contracts from period to period rather than actively trade in and out of markets. In rebalancing, they seek to avoid price impacts. For example, they typically do not carry positions to a contract's spot month (where the risk of price manipulation may be the greatest), instead rolling forward to a non-expiring month.

The AMG believes that diversified, unleveraged investment funds and accounts that take passive, long-only positions should be distinguished from the "massive passives" cited by Commissioner Bart Chilton as posing concerns to be addressed by position limits.[11] Instead of targeting a particular commodity type, such as oil, natural gas, silver or gold, these funds and accounts provide diversified exposure to commodities via the tracking of broad commodity indices. Further, in many cases, these funds invest only a relatively small percentage of their overall assets in commodity investments as part of a broadly diversified portfolio of assets. By virtue of a diversified approach, these funds and accounts do not run up large concentrated exposures in any one commodity that would cause the market impact concerns of "massive passives" cited by Commissioner Chilton. Research indicates that diversified, unleveraged investment funds and accounts that take passive, long-only positions do not contribute to "excessive speculation". For example, studies have shown that they did not cause a speculative bubble or price volatility in commodities from 2005-2008; rather, these problems were likely caused by underlying fundamental supply and demand factors in the commodity

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[10] *See also* CFTC Press Release, U.S. Commodity Futures Trading Commission Charges Hedge Fund Amaranth and its Former Head Energy Trader, Brian Hunter, with Attempted Manipulation of the Price of Natural Gas Futures (July 25, 2007), available at http://www.cftc.gov/PressRoom/PressReleases/pr5359-07.html.

[11] *See, e.g.,* "Fighting Futures", Speech of Commissioner Bart Chilton at Notre Dame University (Nov. 1, 2010), available at http://www.cftc.gov/PressRoom/SpeechesTestimony/CommissionerBartChilton/opachilton-34.html.

markets.[12] Indeed, the AMG believes that evidence supports the many benefits offered to commodity markets by these funds and accounts, whose long-term diversified investments enhance stability, price discovery and producer hedging. Recognizing these benefits, Senator Blanche Lincoln stated in a July 16, 2010 Senate Colloquy her expectation that the CFTC would study whether passive long-only index investing could serve to increase market liquidity to assist in price discovery and hedging for commercial end-users.[13]

In consideration of the above, the AMG respectfully requests the Commission to provide an exemption for diversified, unleveraged funds and accounts that participate in passive, long-only positions.

B. Registered Investment Companies and ERISA Accounts

In particular, the AMG believes that there are other good reasons to exempt registered investment companies and ERISA funds and accounts, as they are already subject to strict regulatory oversight that the AMG believes prevents excessive speculation and market manipulation. Registered investment companies are required to comply with all regulations and related guidance under the Investment Company Act of 1940 (the "**Investment Company Act**"), including those regarding asset coverage, counterparty limits, liquidity and the use of leverage. The Investment Company Act limits the amount of leverage that a registered investment company may obtain, including through the use of derivatives, by requiring the fund to segregate liquid assets or hold offsetting positions on its books in an equivalent amount.[14] In addition, registered investment companies are subject to counterparty limits as a result of Section 12(d)(3) of the Investment Company Act and Rule 12d3-1 thereunder, which generally limit a fund's ability to invest in issuers in a securities-related business. As a result of this requirement and other considerations, the AMG believes that most registered investment companies structure their derivatives so that a fund's exposure to any single counterparty generally does not exceed 5% of the fund's total assets. Registered investment companies electing to be "diversified companies" under the Investment Company Act are required to follow strict diversification requirements, including restrictions against investing more than 5%

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[12] *See, e.g.,* Dwight R. Sanders and Scott H. Irwin, *A speculative bubble in commodity futures? Cross-sectional evidence*, Agricultural Economics 41, 25-32 (2010) ("The empirical results provide scant evidence that long-only index funds impact returns across commodity futures markets."); October 2008 IMF World Economic Outlook. As another example, preliminary analysis of the CFTC Inter-Agency Task Force on Commodity Markets in July 2008 suggested that fundamental supply and demand factors are the underlying cause of oil price volatility rather than speculators. *See* Interim Report on Crude Oil, Interagency Task Force on Commodity Markets (July 2008), available at http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/itfinterimreportoncrudeoil0708.pdf.

[13] Blanche Lincoln, Senate Colloquies, July 16, 2010: "I wish to also point out that section 719 of the conference report calls for a study of position limits to be undertaken by the CFTC. In conducting that study, it is my expectation that the CFTC will address the soundness of prudential investing by pension funds, index funds and other institutional investors in unleveraged indices of commodities that may also serve to provide agricultural and other commodity contracts with the necessary liquidity to assist in price discovery and hedging for the commercial users of such contracts."

[14] Section 18(f) of the Investment Company Act; *see also* Securities Trading Practices of Registered Investment Companies, Investment Company Act Release No. 10666 (Apr. 18, 1979); Merrill Lynch Asset Management, L.P., SEC No-Action Letter (July 2, 1992); Dreyfus Strategic Investing & Dreyfus Strategic Income, SEC No-Action Letter (June 22, 1987).

of total capital in any single issuer, and requirements to invest at least 75% of total assets in cash and securities.[15] In addition, registered investment companies must maintain at least 85% of their assets as liquid investments, are required to calculate and publish net asset values and disclose substantial information about their investments and are obligated to maintain comprehensive compliance programs. All of these requirements help assure that registered investment companies do not engage in manipulative practices, remain too heavily concentrated in any one investment or create systemic risk.

Additionally, under Subchapter M of the Internal Revenue Code of 1986, at least 90% of the annual gross income of a registered investment company must be so-called "qualifying income" in order for it to maintain its tax status as a "regulated investment company." Commodities and derivatives referencing commodities generally do not produce qualifying income under current law. As a result, some registered investment companies use wholly-owned unregistered subsidiaries to invest in commodity derivatives transactions; each subsidiary is included within the regulatory limitations applicable to its registered parent.[16] Nevertheless, any registered investment company's investment in such a subsidiary, and therefore its investment in commodities or commodity-related instruments, is limited to no more than 25% of a registered investment company's assets under the tax diversification provisions of the Internal Revenue Code.[17]

Investment advisers to ERISA accounts are subject to strict fiduciary obligations, including the duty to discharge their duties under a prudence test[18] described by courts as "the highest known to the law,"[19] the duty to diversify the investment of an account's assets so as to minimize the risk of large losses[20] and the duty of loyalty, which requires each adviser to discharge its duties solely in the interest of the account and for the exclusive purpose of providing benefits to participants and beneficiaries.[21] Similarly, the

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[15] Section 5 of the Investment Company Act.

[16] Mutual funds utilizing this parent-subsidiary structure rely on IRS private letter rulings which conclude that income arising from a mutual fund's investment in a subsidiary that invests in commodities investments constitutes qualifying income. These same private letter rulings require such subsidiaries to comply with the requirements of Section 18(f) of the Investment Company Act and all related guidance regarding asset coverage and the use of leverage by mutual funds. *See, e.g.,* I.R.S. Priv. Ltr. Rul. 201039002 (June 22, 2010); I.R.S. Priv. Ltr. Rul. 201037012 (June 4, 2010); I.R.S. Priv. Ltr. Rul. 201030004 (Apr. 28, 2010). In addition, in various SEC No-Action Letters, the SEC has permitted registered investment companies to establish wholly-owned foreign subsidiaries for the purpose of avoiding unfavorable foreign tax treatment or foreign investment restrictions, and has acknowledged that such subsidiaries did not avoid any regulatory requirements since the parent-subsidiary structures were operated in accordance with the Investment Company Act. *See, e.g.,* S. Asia Portfolio, SEC No-Action Letter (Mar. 12, 1997), Templeton Vietnam Opportunities Fund, Inc., SEC No-Action Letter (Sept. 10, 1996), The Spain Fund, Inc., SEC No-Action Letter (Mar. 28, 1988) and The Scandinavia Fund, Inc., SEC No-Action Letter (Nov. 24, 1986).

[17] Section 851(b)(3) of the Internal Revenue Code.

[18] ERISA § 404(A)(1)(B), 29 U.S.C.A. § 1104(A)(1)(B). This provision requires the manager to have conducted a sufficient investigation into the details and particulars of a transaction and its appropriateness for the account involved prior to engaging in a transaction.

[19] *Donovan v. Bierwirth*, 680 F.2d 263, 272 n.8 (2d Cir. 1982).

[20] ERISA § 404(A)(1)(C), 29 U.S.C.A. § 1104(A)(1)(C).

[21] ERISA § 404(A)(1)(A), 29 U.S.C.A. § 1104(A)(1)(A).

Investment Company Act requires advisers to registered investment companies to be registered themselves under the Investment Advisers Act of 1940, which subjects advisers to stringent fiduciary duties of loyalty and care to clients as a matter of law.[22]

The AMG believes that the carefully regulated nature of these funds and accounts effectively obviates the risks of excessive speculation and market manipulation which position limits are intended to address.

IV. Aggregation: The Commission should permit disaggregation of funds and accounts.

If the Commission is ultimately unwilling to adopt the exemption discussed above, the AMG would urge that at a minimum, in recognition of the fact that the size of passive positions is typically not controlled by the sponsor but by the investors that move into and out of diversified, unleveraged funds and accounts, the Commission consider and approve disaggregation among these funds and accounts.

Further, the AMG recommends that in calculating positions under any rules to be adopted by the Commission, investment advisers should report the positions of each of their clients separately and should not be required to aggregate the positions of any fund or account (including any fund that is registered under the Investment Company Act or any ERISA-regulated or state pension plan account) with positions of other funds and accounts managed by the same adviser or its affiliates. The AMG believes that it is not appropriate to require aggregation of positions held by such funds and accounts because each fund or account is effectively independently "controlled."[23] Regardless of whether each such fund and account has an independent account controller as defined in CFTC Rule 150.1(e), each is a separate client of a registered investment adviser, with separate investors and separate investment mandates. As independent legal entities with distinct investment strategies, the funds and accounts have different impacts on the market at any given time. As a further example, due to their regulated nature, and that of registered investment advisers under the Investment Advisers Act, registered investment companies and ERISA-regulated or state pension plan accounts do not, *and under applicable law are not permitted to*, engage in coordinated investment activity for any speculative or manipulative purpose. As discussed above, investment advisers to regulated entities are required as fiduciaries under ERISA and the Investment Advisers Act, as applicable, to make decisions based on the objectives and needs of each individual client without taking into account other clients' positions. Where funds and accounts have separate investment instructions and objectives under the supervision of regulated fiduciaries, there is no reason to expect that the resulting purchase and sale decisions by a manager will result in inappropriate speculation or any manipulation across the group. Senator Blanche Lincoln recognized this distinction when she stated in a July 16, 2010 Senate Colloquy that she

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[22] *See* Sections 206(1) and (2) of the Advisers Act; SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 192-93 (1963).

[23] CEA § 4a(1) provides that "[i]n determining whether any person has exceeded such limits, the positions held and trading done by any persons directly or indirectly *controlled* by such person shall be included with the positions held and trading done by such person; and further, such limits upon positions and trading shall apply to positions held by, and trading done by, two or more persons acting pursuant to an expressed or implied agreement or understanding, the same as if the positions were held by or the trading were done by, a single person." (emphasis added).

"would encourage the CFTC to consider whether it is appropriate to aggregate positions of entities advised by the same advisor where such entities have different and systematically determined investment objectives." This is all the more relevant in instances where funds are managed by different affiliated investment advisers, even if such advisers would not qualify as independent account controllers under Part 150 of the CFTC Regulations.

The AMG recognizes that the existing principles of Part 150 of the CFTC Regulations require aggregating positions of separate funds or accounts unless trading is controlled by independent decision-makers. In any event, the AMG believes that the aggregation exemption for independent account controllers under CFTC Rule 150.3(a)(4) should continue to be respected by the Commission. Separate account controllers are used by many institutions for appropriate fiduciary and business purposes and the Commission should not adopt a rule that would ignore the safeguards already established and restrict fiduciaries from acting in the best interests of their many clients. In particular, asset management firms maintain information barriers and internal firewalls to prevent inappropriate use of information between and among affiliated independent account controllers. Requiring aggregation of separately managed funds and accounts of independent account controllers would require affiliates to share position and trading information, which runs counter to firm best practices and creates potential conflicts of interest that the information walls were intended to prevent. We also agree with the Futures Industry Association that imposing an aggregation requirement based on 10% or greater common ownership could present a significant compliance cost burden with little added benefit.[24]

V. Bona Fide Hedging: A narrow interpretation of "bona fide hedging" would hinder non-harmful, non-speculative activities that investment funds and accounts engage in, such as risk mitigation and investment hedging.

The Dodd-Frank Act requires, in new CEA § 4a(c)(2), that the Commission exempt commercial hedging from position limits on certain physical commodities. Similarly, the AMG believes that the Commission should clarify that a variety of investment-related hedging transactions should also be exempt from speculative position limits. The Dodd-Frank language on "bona fide hedging" is virtually identical to CFTC Rule 1.3(z)(1), which has long been interpreted by the CFTC, and applied by the exchanges, to include portfolio risk-reduction transactions.[25] We believe that the House inserted the commercial hedging provision into Dodd-Frank § 737 to allay concerns, in

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[24] *See* Futures Industry Association, Inc. comment letter (Oct. 1, 2010), available at http://www.cftc.gov/ucm/groups/public/@swaps/documents/file/derivative26sub100310-email3.pdf ("Independently-controlled affiliates often have separate information systems and procedures for back office operations that will require substantial and very expensive modifications in order to allocate and monitor commonly owned positions to abide by aggregated limits.").

[25] In 1987, the Commission issued interpretive guidance clarifying that balance sheet and other trading strategies, where properly structured to have an overall risk-reducing effect, are no less qualified for hedging treatment than strategies that represent a substitute for transactions or positions in a physical channel. *See* Clarification of Certain Aspects of the Hedging Definition, 52 FR 27195 (July 20, 1987). Futures exchanges have since adopted rules recognizing that the range of risk-reduction transactions appropriately exempt from position limits is broader than the strict commercial concept. *See, e.g.*, CBOT Rules 559A-C; CME Rules 559A-C.

particular on the part of members of the House Committee on Agriculture, that new regulation might eliminate or limit exemptions traditionally used by end-users and other physical market participants.[26] There is no indication that the provision was meant to alter the common understanding of "hedging," which generally encompasses a broad range of transactions that offset other specific risks, regardless of whether the hedger is a physical market participant or whether the risk hedged is commercial or financial. This common understanding is reflected in the Commission's instructions regarding disclosure of hedged positions on Form 40. Form 40 instructs that "activities hedged by the use of futures or options markets . . . would include . . . asset/liability risk management, security portfolio risk management, etc."; traders that may use this form to indicate hedged positions include mutual funds, pension funds, endowments, and managed accounts, as well as producers and manufacturers.[27] The AMG agrees with the Commission's instruction as an appropriate articulation of activities that constitute "hedging".

It is also instructive to look at the corollary provisions relating to security-based swaps for interpretation of the hedging concept. Under current security-based position limit rules -- the FINRA position limits on stock options -- exempt hedging includes a range of financial risk-offsetting strategies and is in no way limited to physical market participants.[28] The Dodd-Frank requirement (under Section 763(h)) that the SEC include hedge exemptions from security-based position limits demonstrates Congress's support for this approach regarding positions that are risk-reducing and not speculative.

If the Commission ultimately determines to interpret "bona fide hedging" in a manner that does not exempt all economically hedged positions, the AMG encourages the Commission to use its exemptive authority under CEA § 4a(a)(7) to permit hedging transactions determined by the Commission to be "economically appropriate" to the reduction of risks in the conduct of a market participant's enterprise. We agree with the CME Group that the Commission's authority under CEA § 4a(a)(7) should be broadly construed in order to further the Commission's mission of promoting liquidity and protecting the price discovery function of the U.S. commodity markets.[29]

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[26] The Dodd-Frank Act language specifically requiring the Commission to exempt commercial hedging (new CEA § 4a(c)(2)) was not included in the House Finance Committee, Senate or Treasury version of the Dodd-Frank Act, but originated in the version of the House Committee on Agriculture, chaired by Representative Collin C. Peterson, and was added to the House-passed version in the Peterson-Frank amendment, which also exempted commercial end users from swaps clearing requirements. *See, e.g., House Passes Peterson-Frank Amendment to Strengthen Regulation of Over-the-Counter Derivatives*, U.S. House of Representatives Committee on Agriculture Press Release (Dec. 10, 2009) (statement by Peterson that the Peterson-Frank amendments "will benefit end users' ability to effectively hedge their price risk by not submitting them to onerous cash collateral requirements"); Floor Statement by the Honorable Frank D. Lucas, Ranking Member, House Committee on Agriculture, Re: H.R. 4173, the Wall Street Reform and Consumer Protection Act (Dec. 10, 2009), available at http://republicans.agriculture.house.gov/fs091210.shtml (noting that "we were able to improve areas most important to end-users – the manufacturers, the energy companies and food processors that use swap agreements to manage price risk so they can provide consumers the lowest cost products"); *see also* the Peters-Frank and Boswell-Peterson July 22, 2010 House Colloquies.

[27] *See* CFTC Form 40, Statement of Reporting Trader, Part B, Item 3 and Schedule 1.

[28] FINRA Rule 2360(b)(3)(A)(vii).

[29] As the CME argues, in determining whether a transaction is "economically appropriate", an application for exemption "should be judged on its merits in terms of the specific risks to be hedged, the relevant price relationships, the proposed position size, and the operational procedures for establishing and
(…continued)

Finally, the AMG notes that "risk management" contracts used for asset allocation purposes are eligible for exemption under exchange rules and should be accorded comparable treatment under any Commission rulemaking. The use of futures or swaps, instead of investing in the cash physical commodities market, does not translate into speculative activity; rather there are many legitimate investment reasons to access commodity markets through derivatives.

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The AMG thanks the CFTC for the opportunity to comment in advance of the issuance of any proposed rules setting position limits and for the CFTC's consideration of the AMG's views. The AMG's members would appreciate the opportunity to further comment on these topics. If you have any questions, please do not hesitate to call either Danforth Townley, Davis Polk & Wardwell LLP, at 212-450-4240 or the undersigned at 212-313-1389.

Sincerely,

Timothy W. Cameron, Esq.
Managing Director, Asset Management Group
Securities Industry and Financial Markets Association

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lifting the hedge." CME comment letter (Oct. 25, 2010), available at http://cftc.gov/ucm/groups/public/@swaps/documents/file/derivative26sub102610-email1.pdf.