February 10, 2014

Ms. Melissa Jurgens
Secretary
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, NW
Washington, DC 20581

Re: Aggregation of Positions
(RIN 3038-AD82)

Dear Ms. Jurgens:

Better Markets, Inc.[1] appreciates the opportunity to comment on the above-captioned proposed rule ("Proposed Rule") of the Commodity Futures Trading Commission ("CFTC, Commission"). The Proposed Rule purports to clarify and amend the aggregation regime ("Aggregation Rule") of the rules related to position limits for derivatives ("Position Limits Rules"), in accordance with the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").

INTRODUCTION AND SUMMARY OF COMMENTS

The Position Limits Rules lie at the heart of Title VII. Many decades of successful implementation across a variety of commodity derivatives has proved their essential role in ensuring orderly and fair markets that accurately reflect supply and demand fundamentals. Paramount to the effective imposition of Position Limit Rules is an accurate and comprehensive aggregation methodology. The Proposed Rule, which imposes such an aggregation methodology, must ensure that limits ("Position Limits") are applied to all positions that, in aggregate, may compromise the integrity of their marketplace. It is also key that this Proposed Rule be designed such that Position Limits satisfy all of the statutory goals set by Congress.

1 Better Markets, Inc. is a nonprofit organization that promotes the public interest in the capital and commodity markets, including in particular the rulemaking process associated with the Dodd-Frank Act.

1825 K Street, NW, Suite 1080, Washington, DC 20006 TELEPHONE (1) 202.618-6464 FAX (1) 202.618.6465 WEBSITE bettermarkets.com

In the Dodd-Frank Act, Congress made it quite clear that Position Limits are to be applied in the aggregate at the control entity level.[2] The Commission's Rule to implement the law, however, has been iteratively undermined through successive additions of qualifications and exemptions over the years that diminish its effect. As described below, the Proposed Rules impermissibly weaken aggregation in the following ways:

- Allowing majority ownership to qualify for disaggregation;
- Removing important controls from the information-sharing exemption; and
- Failing to meaningfully address excessive speculation, and ignoring the statutory injunction to aggregate groups or classes of traders such as Commodity Index Traders.

Despite the deliberate and unambiguous mandate by Congress,[3] the Commission continues to craft its Aggregation rules without attention to groups or classes of traders that present, at a minimum, a potential source of excessive speculation. In the Proposed Rules, the Commission also continues to ignore the statutory mandate to "diminish, eliminate or prevent" excessive speculation, and instead focuses exclusively on affecting excessive concentration and potential market manipulation.

As has been demonstrated by numerous academic studies and compelling data set forth in previous letters to the CFTC,[4] **the current level of speculation in the U.S. commodity derivatives markets today is excessive**. The CFTC should therefore be looking to **strengthen** regulation of speculation, not weaken it. As described herein, the Proposed Rules meaningfully weaken the effect of a Position Limits regime, and the Commission must take concrete steps to remediate these weaknesses to provide strong, comprehensive, and effective Position Limits Rules.

DISCUSSION

The Definition of Control Has Been Impermissibly Broadened

Consistent with logic and reason, the longstanding policy of determining positions subject to speculative Position Limits required entities to aggregate positions for which they control the trading together with those held by entities they own.[5] This makes perfect sense, of course, since failing to aggregate all positions at the control entity level would allow traders to easily circumvent Position Limits by creating multiple subsidiaries

---

2 "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." 7 U.S.C. § 6a.

3 "The Commission **shall**, by rule or regulation, establish limits (including related hedge exemption provisions) on the aggregate number or amount of positions in contracts based upon the same underlying commodity (as defined by the Commission) that may be held by any person, including any group or class of traders" 7 U.S.C. § 6a (emphasis added).

4 *See* Better Markets Comment Letter "Position Limits for Derivatives" (Mar. 28, 2011), *available at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=34010&SearchText=better%20markets (incorporated herein as though fully set forth) and upcoming Better Markets Comment Letter "Position Limits for Derivatives" (Feb. 10, 2014); *see also* David Frenk & Wallace Turbeville, *Commodity Index Traders and the Boom/Bust Cycle in Commodities Prices*, (Oct. 14, 2011), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1945570. For a list of further studies, *see* http://www2.weed-online.org/uploads/evidence_on_impact_of_commodity_speculation.pdf.

5 *See* Commodity Exchange Act § 4a.

and dividing its positions among them.

In connection with the Position Limits set out in Section 737 of the Dodd-Frank Act, Congress explicitly preserved the following provision of the Commodity Exchange Act:

> "In 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."[6]

The paradigm example of control, of course, is ownership. Thus, determination of a person's aggregatable positions through a function of direct control and ownership[7] is a faithful implementation of the statute. Indeed, this was reflected in the longstanding aggregation regime for futures and options in current part 150 ("Current Part 150"), as well as the aggregation provisions proposed in the original part 151 Position Limits proposed rule ("Proposed Part 151").[8] And, under rules of statutory construction Congress is presumed to have known this and approved of it when it amended the Position Limits regime in the Dodd-Frank Act but left the ownership and control language in the aggregation provision intact.

However, on May 30, 2012,[9] the Commission proposed an interim Part 151 ("Interim Part 151") which significantly weakened this clear aggregation regime by adding and expanding opportunities for disaggregation.[10] Chief among these was the expansion of the exempted ownership threshold from a reasonable 10 percent to an unreasonable 50 percent under certain conditions.[11]

Now, the Proposed Rule has gone much further by allowing disaggregation in certain circumstances where an entity has majority ownership of another. If 'indirect control' of a subsidiary's positions is not signified by, at a minimum, majority ownership of the entity, then surely it is no longer a meaningful designation.

Allowing disaggregation of majority-owned subsidiaries ignores the statute's clear language regarding indirect control, and therefore violates statutory rules of construction, and indeed directly contradicts the statute. The Commission must therefore reinstate the appropriate 10 percent ownership criterion.

---

6 7 U.S.C. § 6a(a)(1) (emphasis added).

7 Above a *de minimis* 10 percent.

8 Position Limits for Derivatives, 76 Fed. Reg. 4,752 (Jan. 26, 2011).

9 "On May 30, 2012, the Commission proposed, partially in response to a petition for interim relief from part 151's provision for aggregation of positions across accounts, certain modifications to its policy for aggregation under the part 151 Position Limits regime (the "Part 151 Aggregation Proposal'')." Proposed Rule, 78 Fed. Reg. 68,946.

10 Aggregation, Position Limits for Futures and Swaps, 77 Fed. Reg. 31,767 (May 30, 2012).

11 *Id.* at Proposed §151.7(b)(1).

The Proposed Rules Remove Important Controls Regarding the Information-Sharing Exemption

One reasonable exemption from aggregation is for those rare and clear-cut situations where a parent company is legally and practically prevented from exerting even indirect control. Independent account controllers arguably fit this requirement. However, "Chinese walls" do not in all but the most unambiguous cases.[12] Even the attempted limiting language of the Proposed Rule requiring "separate physical locations"[13] is eviscerated in the preamble which assures market participants that separate physical locations may be interpreted to mean any separation by a locked door.[14]

This is only a modest step above a purely conceptual Chinese wall, and is the lowest possible standard of separation. Thus, the Proposed Rules must be strengthened to provide realistic guidelines of how two disaggregated entities must maintain meaningful separations of location and information.

In seeking clear-cut rules that demonstrate the maximum alignment with their statutory mandate, the continued systematic weakening of the Information Sharing Provision is of particular concern. As discussed in the preamble, the initial exemption from aggregation under regulation Section151.7(i) applied strictly "under certain conditions where the sharing of information would cause a violation of Federal law or regulation."[15] This determination was required to be substantiated by an opinion of counsel setting forth the legal basis for the exemption. This is an appropriate exemption and a standard method for market participants to establish eligibility.

However, the exemption was significantly weakened in Interim Part 151, which stated that:

> "situations where the sharing of information was restricted under law would include circumstances in which the sharing of information would create a 'reasonable risk' of a violation--in addition to an actual violation--of federal law or regulations adopted thereunder."[16]

---

12 "It has long been suspected, and is now beyond reasonable dispute, that in important contexts Chinese walls fail to prevent the spread of non-public information within financial conglomerates. For example, empirical studies show that information leaks from the investment banking units of firms to trading units, where it is used for profitable trading. Chinese walls are thus accorded legal effect, despite often failing to have practical effect." Tuch, Andrew, *Financial Conglomerates and Chinese Walls*, Washington University in St. Louis Legal Studies Research Paper No. 13-11-01 (Dec. 15, 2013), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2363312.

13 Proposed Rule at §150.4(b)(2)(i)(C).

14 "The requirement of 'separate physical locations' in proposed rule 150.4(b)(2)(i)(C) would not necessarily require that the relevant personnel be located in separate buildings. The Commission believes that the important factor is that there be a physical barrier between the personnel that prevents access between the personnel that would impinge on their independence. For example, locked doors with restricted access would generally be sufficient, while merely providing the purportedly ''independent'' personnel with desks of their own would not." Proposed Rule, 78 Fed. Reg. 68,962. Similar principles would apply to sharing documents or other resources." *Id.* at 68,962.

15 Proposed Rule, 78 Fed. Reg. 68,948.

16 Proposed Rule, 78 Fed. Reg. 68,948.

Making matters worse, the exemption was no longer limited to federal law, but expanded to the virtually unlimited universe of all federal, foreign, and state laws. While the Commission maintained the important requirement that such risk of violation was described and attested by an opinion of counsel, the scope of the exemption was broadened to constitute an indefensible departure from the Commission's historical aim to "craft narrowly-tailored exemptions, when and if appropriate, to the basic requirement of aggregation when there is either ownership or control of an entity."[17]

This change weakens the accountability of firms attempting to make use of the exemption, and will not reduce or prevent excessive speculation. Indeed, as the Commission itself has noted,[18] the removal of this important protection may enable the exemptions to become loopholes that increase excess speculation and defeat the purpose of the statute.

In the Proposed Rule, the Commission has sought to remove the final remaining protection of required legal opinion. An opinion of counsel is a reliable, thorough, and formal document that provides a distinct level of accountability to the firm making the attestation. A memorandum of law, which may be composed by any employee or any other person "so long as it is clear from the memorandum how the risk applies to the person providing the memorandum"[19], does not provide sufficient accountability.

The Commission purports to justify these dramatic changes by relying on assertions from various industry representatives claiming the high cost to market participants in obtaining an opinion of counsel as to their "reasonable risk" of violation, without demonstrable benefits. There are several serious flaws in these claims and the Commission's proposed changes based on them.

First, the Commission initially required the opinion of counsel due to concern "that certain market participants could potentially use [the exemption] to evade the requirements for the aggregation of accounts."[20] Where there is a risk of evasion, and when this risk is heightened in connection with a weakening of existing rules at the request of industry,[21] the regulators should provide appropriate inducements for the regulated entity to respect the regulations. Weakening the standard from an opinion of counsel to a memorandum of law creates the worst of both worlds: the appearance of compliance, without the substance.

---

17 Proposed Rule, 78 Fed. Reg. 68,951.

18 "However, the Commission remained concerned that certain market participants could potentially use the existing and proposed expansion of the exemption in regulation 151.7(i) to evade the requirements for the aggregation of accounts. In this regard, the proposed amendment to part 151, consistent with the exemption for federal law information sharing restriction, included the requirement to file an opinion of counsel specifically identifying the particular law and facts requiring a market participant to claim the exemption." Proposed Rule, 78 Fed. Reg. 68,948.

19 *Id.*

20 Proposed Rule, 78 Fed. Reg. 68,948. It is notable that the Proposed Rules have further expanded the exemption without addressing these heightened concerns.

21 *See* Industry Petition *available at* http://www.cftc.gov/stellent/groups/public/@rulesandproducts/documents/ifdocs/wgap011912.pdf.

Further, it should be noted that the broadening of applicable jurisdictions and removing compulsory legal opinion demonstrates the successive deference to industry as it requests to weaken regulations against it. In their petition submitted to regulators in January 2012, industry participants demanded that, in addition to actual violations of federal law, the Commission include **potential** violations[22] of any State or Foreign law[23], as a basis for the information sharing exemption from aggregation.

This much broader jurisdiction would, of course, significantly increase the scope, and therefore cost, of an applicable opinion of counsel.[24] The Commission proposed new rules in response to their petition, largely heeding their suggestions at the expense of many key strengths in the rule. In their public comments submitted in response to the amended rule, the same industry participants then argued that opinions of counsel are too expensive – and that the level of required documentation should be reduced.[25] This is a downward spiral of accommodation that has reduced a common-sense exemption to a catch-all loophole through which nearly any disaggregation may be allowed.

The Commission must seriously reconsider its inappropriate gutting of the information-sharing provision. By reinstating the requirement to provide a legal opinion in filing for exemption, limiting applicability to actual violations of law rather than possible ones, and restricting the domain to Federal laws, the Commission can restore a reasonable scope to Section 150.4(b)(8) and satisfy the statutory purpose of the law.

Excessive Speculation and Groups or Classes

Congress enumerated four objectives that the CFTC must seek to achieve as it sets Position Limits.[26] First and foremost, "to the maximum extent practicable" the agency must "diminish, eliminate, or prevent excessive speculation."[27] Other objectives include ensuring "sufficient market liquidity for *bona fide* hedgers," and ensuring that "the price discovery

---

22 "The Federal Law Exemption, as currently constructed, will likely be of limited usefulness and may not cover the full range of circumstances that the Commission may have thought it would, as there are only a few applicable circumstances where the sharing of information is per se illegal under Federal law." Working Group Petition *available at* http://www.cftc.gov/stellent/groups/public/@rulesandproducts/documents/ifdocs/wgap011912.pdf.

23 "The resulting conflict between state law and Federal law can and should be avoided by modifying Rule 151.7(i) to afford exemptive relief for potential violations of state law. In a similar manner, the commission should afford exemptive relief should a firm possibly violate local, foreign or international law by sharing information to comply with the Final Position Limit Rules." Working Group Petition *available at* http://www.cftc.gov/stellent/groups/public/@rulesandproducts/documents/ifdocs/wgap011912.pdf.

25 The Commission is persuaded by the commenters saying that requiring a formal opinion of counsel may be expensive and may not provide benefits, in terms of the purposes of this requirement, as compared to a memorandum of law. As noted in the Part 151 Aggregation Proposal, the purpose of this requirement is to allow Commission staff to review the legal basis for the asserted regulatory impediment to the sharing of information (which should be particularly helpful when the asserted impediment arises from laws that the Commission does not directly administer), to consult with other regulators as to the accuracy of the assertion, and to coordinate the development of rules surrounding information sharing and aggregation. The Commission expects that a written memorandum of law would, at a minimum, contain information sufficient to serve these purposes." Proposed Rule, 68,950.

26 7 U.S.C. § 6a(a)(3)(B).

27 *Id.*

function of the underlying market is not disrupted."[28] These goals clearly place orderly market function, and the needs of commercial hedgers, at the forefront.

Thus, should the level of market-wide speculation in a given contract become large enough to threaten the contract's ability to appropriately serve the needs of commercial hedgers, it must be limited. The Proposed Rule must therefore provide for an aggregation regime that accounts for this. Given that financial speculation as a class of trades creates excessive speculation and otherwise interferes with the orderly functioning of the markets, the statute requires that it be limited to achieve the goals of the statute. To do otherwise would impermissibly promote and facilitate the profit-seeking activity of financial speculators over *bona fide* hedgers, price discovery, and the elimination of excessive speculation.

Importantly, Congress explicitly clarified and strengthened the aggregation requirements previously contained in the Commodities Exchange Act by applying them to contracts in the same underlying commodity and to economically related contracts, across all venues.[29] **Moreover, Congress explicitly inserted language expanding the CFTC's aggregation powers to cover "any group or class of traders."[30]** Yet, the proposed rule shows no indication that the Commission has sought to identify groups or classes of traders that might be suitable candidates for aggregation. This is despite the fact that many commenters have requested that the Commission investigate Commodity Index Traders, an identifiable group or class of traders for which there is overwhelming evidence that they are a cause of excessive speculation.[31]

To fulfill its statutory mandate, **the Commission must investigate whether the class of Commodity Index Traders or any other group or class of traders is a significant cause of excessive speculation.** Failure to do so would not only ignore the clear language of the statute, it would leave the American public at the mercy of unwarranted price fluctuations and higher costs that result from excessive speculation.

CONCLUSION

Congress gave the CFTC a **clear mandate** to set Position Limits in aggregate across accounts sharing control and to eliminate excess speculation, whether caused by "a group or class of traders" or otherwise. The CFTC has neither good reason nor authority to deviate from the law.

As a result, some firms may have to adapt their existing business practices. A firm with certain legal exposures, for example, may need to obtain a legal opinion to avail itself of an exemption. Firms with mere "Chinese walls" may need to cease trading commodity derivatives in multiple divisions. These are simply results of the law, which are policy decisions made by the Legislative Branch, and not a discretionary matter for a regulator.

---

28 *Id.*

29 Dodd-Frank Act § 737 (a) (2).

30 Dodd-Frank Act § 737 (a)(3)(A).

31 *See* Better Markets Comment Letter "Position Limits for Derivatives" (Mar. 28, 2011), *available at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=34010&SearchText=better%20markets.

1825 K Street, NW, Suite 1080, Washington, DC 20006 TELEPHONE (1) 202.618-6464 FAX (1) 202.618.6465 WEBSITE bettermarkets.com

Rather than weakening the existing rules to the point where they fail to adequately implement Congress's mandate, the CFTC's task is to enact the law.

The integrity of the markets and end-users depends on the Commission to maintain a fair and orderly market that eliminates excessive speculation.

Sincerely,

Dennis M. Kelleher
President & CEO

Caitlin Kline
Derivatives Specialist

Better Markets, Inc.
Suite 1080
1825 K Street, NW
Washington, DC 20006
(202) 618-6464