ISDA Safe, Efficient Markets

February 23, 2017

Submitted Electronically

Mr. Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
Washington, DC 20581

Re: Position Limits for Derivatives: Re-Proposal (RIN 3038-AD99)

Dear Mr. Kirkpatrick:

The International Swaps and Derivatives Association, Inc. ("ISDA")[1] appreciates the opportunity to submit these comments with respect to the notice of proposed rulemaking (the "Proposal")[2] published by the Commodity Futures Trading Commission ("CFTC" or the "Commission") regarding re-proposed rules governing position limits of physical commodities and related derivatives.

As the trade association for the global derivatives market, ISDA monitors regulatory developments that could affect the ability of market participants to use derivatives to,

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1 Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 850 member institutions from 67 countries. These members comprise a broad range of derivatives market participants including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's web site: www.isda.org.

2 Position Limits for Derivatives, 81 Fed. Reg. 96704 (Dec. 30, 2016).

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among other things, execute hedging and risk management strategies. ISDA, either on its own or jointly with fellow trade associations, has previously submitted a series of comment letters addressing the CFTC's various proposed position limits rules,[3] each of which we also incorporate herein. We believe many of the points raised and extensive analysis in those pervious comment letters remain applicable to the Proposal.

Although ISDA is supportive of the incremental changes the CFTC has made to the proposed position limits framework in response to commenters on the prior releases, ISDA and its members continue to have a number of concerns about several aspects of the re-proposed position limits rules, both from a practical and logistical perspective as well as substantively:

- ISDA continues to believe that there is no statutory authority for the imposition of position limits as currently proposed. The implementation of position limits could significantly harm market liquidity and reduce the ability of commercial market participants to engage in hedging and risk management activities, without any commensurate market protection or benefits. The current Proposal structure should be abandoned in favor of a principles based and incremental approach.

- If the Commission does pursue a positions limits rulemaking in a form similar to the Proposal, the structure of the ruleset should be significantly revised. For example:

    - Position limits should not apply to derivatives held outside of the spot month.

    - Position limits should not apply to financially settled futures contracts.

    - Position limits should not apply to swap positions.

    - The Proposal should include a risk management exemption.

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[3] Those comments include, among others, the following: ISDA/SIFMA Comment Letter re Proposed Regulations Regarding Position Limits for Derivatives, January 11, 2011; ISDA/SIFMA Comment Letter re Notice of Proposed Rulemaking – Position Limits for Derivatives (RIN 3038 AD15 and 3038-AD16), March 28, 2011; ISDA/SIFMA Comment Letter re Position Limits for Futures and Swaps (RIN 3038- AD17), January 17, 2012; ISDA Comment Letter re Notice of Proposed Rulemaking – Position Limits for Derivatives (RIN 3038-AD99), February 10, 2014; ISDA/SIFMA Comment Letter re Reopening of Comment Periods – Position Limits for Derivatives (RIN 3038-AD99) (the "2014 letter") and Aggregation of Positions (RIN 3038-82), July 7, 2014; ISDA Comment Letter re: Aggregation of Positions; Supplemental Notice of Proposed Rulemaking (RIN 3038-AD82), November 12, 2015; and ISDA Comment Letter re: Position Limits for Derivatives: Certain Exemptions and Guidance (RIN 3038-AD99), July 13, 2016 (the "2016 Letter").

- In addition, multiple technical changes to the proposed rules are required in order to mitigate the risk of significant market dislocation and disruption in the event the CFTC does adopt the Proposal as a final rule. For example:
    - The proposed exemptions for bona fide hedging should be expanded.
    - The delegation of exemptive authority to exchanges should be clarified.
    - The spread exemption guidance requiring exchanges to certify that any exchange approval of a spread exemption would increase liquidity should be eliminated.
    - The framework for required reporting of positions is burdensome and unworkable and should be modified or eliminated.
    - Cross-commodity netting should be broadly permitted to recognize prevailing market practice.
    - The calculation of estimated deliverable supply should be revised and specified.
    - Any final rule that is adopted should be phased-in over at least 12-months and should include clear and express "grandfathering" provisions.
    - The CFTC should collaborate with foreign regulators to ensure cross-border harmonization.

I. The CFTC must re-approach its position limits rulemaking efforts with a fresh perspective.

A. There continues to be no statutory authority for the position limits proposal in its current form.

While ISDA does appreciate the fact that the CFTC has made an effort to be responsive to industry and commenter concerns and has included changes in the Proposal reflecting several comments received on prior proposals, the CFTC continues to rely on its incorrect conclusion that the Dodd-Frank amendments to CEA section 4a(a) amounted to an unqualified mandate that the Commission impose position limits.[4] This is not supported by the statute, which unambiguously identifies standards that the CFTC must follow when it purports to exercise its position limits authority.

[4] For further analysis, *see generally* 2014 Letter at page 4; 2016 Letter at page 4.

The Commodity Exchange Act (the "CEA") provides that the CFTC may adopt position limits "as the Commission finds are necessary to diminish, eliminate, or prevent [the] burden" of "[e]xcessive speculation[,] . . . as appropriate."[5] Instead of attempting to fulfill this statutory requirement, the current Proposal attempts to salvage a rule structure that has already been overturned by the courts in one instance and that has now been re-proposed, supplemented and re-proposed again through a cumulative body of releases that span thousands of pages. Despite the serial proposals and re-proposals, the current proposal continues to fail to demonstrate that position limits are a necessary and appropriate solution for or response to any specific risk, problem or inefficiency in the commodity derivatives markets. The Commission has not provided empirical or data driven support for position limits, nor has the CFTC been able to point to any instance of trading misconduct or market inefficiency that would justify the use of the position limits as proposed. Continuing to ignore the clear instruction from Congress, the Proposal recycles the same irrelevant case study discussions[6] that were included in its 2013 release. The Proposal also, and consistent with the previous position limit proposals, refuses to attempt to provide any definition of "excessive speculation," the key statutory purpose for which the CFTC could justify position limits. In order to reach a finding of both the necessity and appropriateness of any position limits rule proposal, the Commission must determine that excessive speculation exists and that such limits would in some way curb or diminish the effects thereof.

B. The CFTC should abandon the Proposal in favor of a principles based incremental approach to position limits.

ISDA believes that if the Commission intends to pursue a position limits rulemaking that complies with the requirements of the CEA, the CFTC should first develop a practical and principles based framework for position limits that is supported by the statute. Specifically, as will be discussed further below, ISDA believes that the CFTC should first consider solely whether to expand its existing federal position limits program for agricultural commodity futures contracts to other physically delivered commodity futures contracts – and to the extent it does so, it should delegate the administration of limits for non-agricultural commodities to the exchanges. The CFTC has identified no factual or regulatory basis from which it could support imposing limits on financially settled contracts, whether that is futures or swaps, or on contracts that are beyond the spot month. Starting with only physically delivered commodity futures contracts in the spot month would allow the Commission to address the only actual area where excessively large positions present a potential risk of commodity price volatility or manipulation while gaining valuable data on market benefits and impact. In contrast, the wider scope of limits proposed in each of the CFTC's prior proposals, amendments and re-proposals

5 *See* CEA section 4a; 7 U.S.C. § 4a. (emphasis added)

6 See generally, Proposal at n. 158 and 187 (discussing the Hunt Brothers and Amaranth cases).

related to position limits for swaps have been met by overwhelming public comment indicating that the rules are impractical, unworkable, and unnecessary. Similarly, the comments have also made clear that such limits would present their own systemic risk to markets by impairing liquidity and ultimately limiting the ability of commercial market participants and end-users to hedge and manage risks – thus limiting their ability to make efficient capital allocation decisions and impairing their ability to make the long-term investments that create economic growth and jobs.

The CFTC has also failed to explain why accountability levels, rather than fixed position limits, would not appropriately allow it to manage and monitor traders with large positions. On this point, ISDA again observes that the CEA does not prohibit accountability levels; instead, the CEA authorizes the Commission to set limits on positions in contracts on physical, non-excluded commodities only as necessary and appropriate to prevent "excessive speculation." Accountability levels will permit the Commission to achieve the same purpose as position limits, but without imposing undue costs on market participants that will accompany fixed limits, and ISDA continues to encourage the Commission to consider where and how accountability limits may be used to mitigate the cost and burden impact of its positions limits proposals. Exchanges have used accountability limits as a successful surveillance and market monitoring tool for many years, and the Commission should embrace rather than reject that experience and learning.

The principles based approach adopted by the CFTC should also broadly empower exchanges to administer a hedging and risk management exemption program. The CFTC must recognize its role, as it is expressly articulated in the CEA, as overseeing "a system of effective self-regulation of trading facilities, clearing systems, market participants and market professionals."[7] The CEA did not contemplate that the CFTC (and not the exchanges) would be managing the technical details of market regulation, such as the precise terms, limits, and conditions that will apply when seeking a hedging or risk management exemption from position limits. To that end, a successful CFTC positon limits rule will provide a practical, principles based and common sense definition of both hedging and risk management that is to be interpreted and applied by the exchanges, using their experience and expertise, for the purposes of recognizing hedging and risk management exemptions from position limits. To the extent the exchanges require data or information from market participants to support claiming or relying on a hedging or risk management exemption, the exchanges should be empowered to request and obtain such data. This approach should also recognize, from the CFTC's perspective, the extensive breadth of existing tools the CFTC has at its disposal including large trader position reporting rules, enhanced market surveillance authority, broad special call authority and as discussed above, exchange-based limits.

[7] 7 U.S. Code § 5.

II. If the Commission does pursue a positions limits rulemaking in a form similar to the Proposal, the structure of the ruleset should be significantly revised.

A. Non-spot-month position limits are not necessary.

ISDA continues to urge the Commission to withdraw in its entirety any aspect of the Proposal that would impose position limits outside of the spot month (*i.e.*, non-spot month limits). The Commission has failed to establish that non-spot month limits are necessary or appropriate, or justified by any data or empirical evidence presented in the Proposal. As a result, the proposed position limits, to the extent they would apply in the non-spot month, are arbitrary and capricious and thus cannot be lawfully adopted as a final rule.

Non-spot month limits could have significant impact, and could result in a shift in market structure. Out-the-curve liquidity could disappear, along with the ability to hedge for market participants, as a direct result of the imposition of inappropriate non-spot month position limits. Similarly, markets could become further fragmented, as they have in response to other of the CFTC's Dodd-Frank rulemakings, including the swap execution facility rules. Moreover, and more importantly, nothing in the Proposal, like the prior proposals, provides any support for the proposition that these negative effects will be offset by greater protections to the market and market participants from these limits. They are therefore very likely to harm market participants without any corresponding benefits. Similarly, the Proposal fails to undertake a cost benefit analysis that sufficiently assesses the impact and cost of non-spot month limits on markets. At a minimum, the CFTC should refrain from regulating non-spot-month positions until it can establish a clear record of empirical support for such regulatory action.

B. Limits should not apply to financially settled futures contracts.

Like non-spot month limits, if position limits apply to financially settled contracts, the traders that provide the liquidity against which hedgers and commercial market participants trade may be forced to exit the market or to curtail their trading. A structural market shift could result wherein the futures and swaps markets fail to serve as a venue for price discovery and managing and hedging commercial risk.

Additionally, the Commission has not demonstrated that financially or cash-settled contracts are either disruptive to the markets or that position limits on these contracts would be useful in combatting excessive speculation or effective at limiting price distortion. Because a cash-settled contract does not, by definition, result in any activity in the underlying physical commodity (these contracts are, instead, dependent upon and generally price based on a reference to the physical market), the potential for a position in a cash-settled contract to disrupt or distort the price of a physical commodity is essentially non-existent. There is no evidence, nor does the Commission offer any evidence, that trading in cash-settled contracts influences the prices of either physically settled contracts or of physical commodities, generally.

Rather, these markets are used by both commercial and financial hedgers alike in the process of managing risks resulting from activity in the physical markets. Position limits on cash-settled commodities will reduce market liquidity and increase transaction costs for hedgers, while attaining no identified related benefits.

C. Limits should not apply to swaps positions.

As with non-spot month limits and financially settled contracts, the CFTC has not undertaken any meaningful effort to demonstrate that market participants are using swap transactions to engage in excessive speculation.

The Commission itself admits that its swaps data collection efforts remain a substantial work in progress, even following the implementation of the Dodd-Frank swap reporting program.[8] Imposing position limits on swaps, in the absence of valid data available to even define that market, has the potential for significant market disruption. The release does not indicate how or whether positon limits on swaps would solve for a market problem – in large part because the release does not identify or define any "market problem" that position limits for swaps are intended to address. Just like position limits on contracts outside the spot-month and financially settled contracts, the primary impact of position limits on cash-settled commodity swaps will be to reduce market liquidity and increase transaction costs for commercial market participants, thus reducing their ability to hedge commercial risks, with no related benefit.

D. The Proposal should include a risk management exemption.

Any position limits rule adopted should include an express "Risk Management Exemption", which is different than a hedge exemption and is meant to permit market participants to enter into futures and swaps positions to manage financial and other risks. The CFTC and the exchanges have recognized risk management exemptions, without incident, for decades. The CFTC should affirm that its positon limit rules will permit

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8 "The Commission is expending significant, agency-wide efforts to improve data collection and to analyze the data it receives." Proposal at 96721. While the Commission notes that it is "satisfied with the quality of the data on which it bases [this Proposal]" (*ibid*), it does not reconcile that observation with the fact that the Commission only recently (on June 27, 2016) finalized amendments to its reporting requirements for cleared swaps and the compliance date for those changes was not until December 27, 2016, after the date of the Proposal. More generally, the Proposal does not address Acting-Chairman Giancarlo's statements, made in a January 2017 speech, that: "The CFTC has faced many challenges in optimizing swaps data ranging from data field standardization and data validation to analysis automation and cross-border data aggregation and sharing. Market participants vary significantly in how they report the same data field to SDRs. Those same SDRs vary in how they report the data to the CFTC." Available at: http://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo-19#P31_7549.

market participants to engage in risk management activities. In light of the complete absence of actual market problems or inefficiencies associated with or attributable to legitimate risk management practices, the CFTC's rules should include a robust risk management exemption that encourages these prudent and traditional risk management activities.

III. Multiple technical changes to the proposed rules are required in order to mitigate the risk of significant market dislocation and disruption in the event the CFTC does move to a final rule.

A. The proposed exemptions for bona fide hedging should be expanded.

Any position limits final rule should expand the availability of thed bona fide hedging exemption to include all positions commonly used by market participants to hedge their physical commodity risk. More generally, the bona fide hedging definition must not be overly restrictive in its application of the economically appropriate test such that it fails to recognize that firms may measure and hedge or manage risk at any of the enterprise, legal entity, desk, book, trader or asset level. The bona fide hedging definition should not be formulated so as to dictate the specific business model and methodology that a commercial market participant must follow in hedging and risk managing their activities.

In addition to the exchange administered process for recognizing non-enumerated bona fide hedging positions, the Commission should include in any final rule a general process, with appropriate authority delegated to the exchanges, though which they may also exempt a traders' particular position from limits on a case-by-case basis pursuant to the authority under CEA Section 4a(a)(7).

B. The delegation of exemptive authority to exchanges should be clarified.

While ISDA appreciates the proposed rule's delegation of authority to exchanges in connection with granting exemptions for non-enumerated bona fide hedging positions, the Commission should further clarify the deferential nature of any subsequent review of an exemptive grant. ISDA greatly supports the recognition by the Commission of both (i) the experience and expertise that the exchanges are able to offer to this aspect of the position limits rules and (ii) the practical cost and logistical limitations that the Commission would face if attempting to administer the exemption process on its own. However, in order to ensure realization of these objectives, ISDA strongly encourages the Commission to clarify, to the maximum extent possible, its intention to delegate these functions to the exchange. Market participants are concerned that, absent an express commitment from the CFTC to defer to exchange decisions, the process could itself become disruptive to the markets and market participants. The Commission should similarly evaluate the benefits of extending to the exchanges authority to grant bona fide hedge or risk management exemptions outright (and without CFTC review, other than the authority of the CFTC to review generally an exchange's exercise of this authority).

Additionally, ISDA continues to be concerned about the lack of clarity on the expected level of coordination that is to occur among different exchanges with respect to limits and exemptions across markets. Each individual exchange should have the authority to determine, using its particular market expertise, the appropriate exemptions for its markets. However, the exchanges should not be subject to different review determinations by the CFTC with respect to exemptions granted from the limits on contracts for the same or related commodities. This goal would be furthered by the establishment of standards applicable to all exchanges, so that actions by different exchanges are dealt with in a consistent manner.

C. The spread exemption guidance should be modified or eliminated.

The Proposal continues to require that before granting a spread exemption, an exchange must certify that the specific exemption increases liquidity. No requirement in the CEA or any other statutory authority implicates such a requirement, and such requirement actually misplaces the liquidity requirements in the CEA, which says that the burden is on the CFTC to confirm that position limits, if adopted, will continue to ensure sufficient liquidity for bona fide hedgers.[9] In contrast, the Proposal would place the liquidity burden on the exchanges or market participants seeking an exemption. This requirement is inconsistent with the Commission's statutory mandate and logically inconsistent: the purpose of the spread exemption is to recognize the more limited speculative opportunities afforded by such positions, because in a spread, a long on one contract is offset by a short on another contract – a spread is a position in the basis between two contracts rather than a view on the contracts themselves. The primary purpose of a spread is not to increase liquidity but to create the exposure to this basis.

D. The framework for required reporting of positions is unworkable and should be modified or eliminated.

The various reporting conditions applicable to both market participants and exchanges in connection with seeking, obtaining and maintaining a valid exemption from position limits are overly broad and completely unworkable. In our view, market participants should not be required to update a report every time they change/modify their position, which would not add value to either the exchange's or the Commission's oversight. More importantly, neither exchanges nor the Commission are likely to have resources available to meaningfully review these reports. ISDA observes that the CFTC always retains the ability to obtain this information, as needed, for example via a special call, and ISDA encourages the Commission not to finalize rules that would impose impractical and unnecessary reporting requirements.

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[9] *See* CEA Section 4a(a)(3).

E. Cross-commodity netting should be permitted to recognize prevailing market practice.

Given the strong correlative relationships of certain commodities, permitting cross-commodity netting is vital in recognizing the current prevailing market practice. While ISDA understands the difficulty of setting and calculating a requisite level of correlation sufficient to permit such netting, we believe that permitting a market participant to demonstrate that a particular commodity pair reaches a threshold level is a pragmatic approach. Alternatively, cross-commodity netting (and cross-commodity hedging) could be permitted by the CFTC within a framework of recognizing those cross-commodity relationships that are in wide use by market convention and practice. The conditions applicable to cross-commodity netting must not unreasonably restrict these risk management and hedging practices by requiring, for example, an artificial quantitative threshold correlation factor.

F. The calculation of estimated deliverable supply should be revised and specified.

The "estimated deliverable supply" methodology that is proposed remains ambiguous and unreliable. ISDA's concern is that this definition could become a tool the CFTC uses effectively to lower position limits without going through a formal notice and comment process. If the CFTC were to specify how it intends to develop its own estimates of deliverable supply, the definition would be less susceptible to arbitrary interpretation. For that reason, the Commission should always publish its estimates of deliverable supply for public review and comment – and the CFTC should always identify the data that it uses to reach its estimates. Moreover, the CFTC should permit challenges to the CFTC's estimated levels by demonstrating that they do not accurately reflect all sources and levels of actual market supplies.

G. Any final rule on position limits should be phased-in.

To the extent the Commission finalizes positon limits, there must be at least a 12-month phase-in as well as clear and express "grandfathering" provisions that ensure any preexisting positions may be held and rolled even after the final rules go into effect. This grandfathering of current holdings and a phase-in period is essential for the technology system builds, new compliance procedures and monitoring programs which will be required by market participants prior to complying with a new rule program

H. The Commission should address cross-border harmonization.

To the extent that the Commission does move forward to finalize any aspect of the position limits rules, we continue to request that the Commission collaborate with foreign regulators to avoid a multiplicity of differing compliance regimes, each with their own requirements and timelines, affecting the same market participants. Specifically, for market participants that transact in multiple jurisdictions, the Commission must provide clear rules and guidance addressing its plans to harmonize its position limits efforts with

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those of its fellow global regulators. This was and remains a major area of uncertainty and ambiguity for market participants as they seek to comply with the broader set of the Commission's Dodd-Frank swaps rulemakings. International collaboration has been highlighted as a priority by Acting Chairman Giancarlo[10] and ISDA and its members hope to avoid a position limits implementation process that could independently disrupt domestic and global markets if done without careful cooperation among and between global regulators.

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10 *See* Keynote Address of Commissioner J. Christopher Giancarlo, SEFCON VII, January 18, 2017 ("Regulators must set limits on the cross-border application of swaps rules to achieve the ends of market reform in a spirit of cooperation and deference.").

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ISDA appreciates the opportunity to provide these comments. If we may provide further information, please do not hesitate to contact the undersigned or ISDA staff.

Sincerely,

Steven Kennedy
Global Head of Public Policy

cc: J. Christopher Giancarlo, Acting-Chairman

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