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March 28, 2011

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

Re: Position Limits for Derivatives

Dear Mr. Stawick:

The Investment Company Institute¹ appreciates the opportunity to provide the Commodity Futures Trading Commission (“CFTC”) with comments regarding its proposal to establish position limits for derivatives pursuant to Section 737 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank Act”).² As investors in the futures and swaps markets, investment companies registered under the Investment Company Act of 1940 (“RICs”) support the important objectives of preventing market manipulation and sudden price fluctuations in the commodity markets.³

Imposing position limits on RICs that invest in futures contracts or fully collateralized swaps to replicate the performance of commodity indices not only is unlikely to advance the public interests of efficient price management and discovery in the commodity futures and swaps markets but also may

¹ The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of \$12.74 trillion and serve over 90 million shareholders.

² CFTC Release, *Position Limits for Derivatives*, 76 FR 4752 (January 26, 2011), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-1154a.pdf>. We are pleased that the CFTC has clarified in its Explanatory Notes that the proposed position limits would exclude index swaps and futures. See Proposed Position Limits for Derivatives, Explanatory Notes, on Setting Non-spot-Month Position Limits, January 26, 2011, available at <http://www.cftc.gov/ucm/groups/public/@swaps/documents/file/nsmposlimits.pdf>. We recommend that the CFTC include such clarifying language in any position limit rules that it adopts.

³ See, e.g., Letter from Karrie McMillan, General Counsel, Investment Company Institute, to David A. Stawick, Secretary, Commodity Futures Exchange Commission, dated January 3 (letter supporting CFTC examination of its authority to prohibit certain trading practices deemed disruptive of fair and equitable trading).

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undermine them. The unintended consequences from imposing position limits without careful analysis also could impact adversely certain RIC investors. Accordingly, we recommend that the CFTC establish an exemption from any position limits that it adopts for RICs that comply with the leverage requirements of the Investment Company Act of 1940 (“Investment Company Act”) and that take passive, long-only positions.⁴

Aside from our exemptive recommendation, ICI is concerned that the CFTC’s proposal to impose position limits is premature and could result in negative consequences to the commodity markets. In its proposal, the CFTC acknowledges that it currently has insufficient data on commodity market positions to analyze and determine either the necessity for, or the appropriate levels of, position limits to curb excessive speculation in these markets. Consequently, we recommend that the CFTC delay action until such time as it can gather sufficient data to warrant imposing position limits in these markets.

If the CFTC determines to proceed with the proposal, without providing an exemption for funds, we recommend that it modify the proposal, as discussed below, with respect to aggregation, the definition of bona fide hedging, and the position limits formula, among other items. We also recommend that the CFTC phase in any position limits that it adopts to minimize market disruption. Finally, we question the appropriateness of the “position points” regime, which the CFTC has referred to simultaneously with the publication of the proposal.

I. Exemption for Funds

We previously recommended that the CFTC provide an exemption from position limits for funds that comply with the leverage requirements of the Investment Company Act and that take passive, long-only positions.⁵ The CFTC’s proposal does not include such an exemption or include any discussion as to why an exemption for funds would be inappropriate. As discussed in this letter, we continue to believe that an exemption is warranted and necessary to protect fund investors and to balance the costs and burdens with the benefits of the proposed regulation of futures and swap markets position limits.

Section 737 of the Dodd-Frank Act requires the CFTC to set position limits “as appropriate” 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.⁶ That section also authorizes the CFTC to “exempt, conditionally or unconditionally, any

⁴ For purposes of this letter, we refer to RICs meeting these requirements as “funds.”

⁵ See Letter from Karrie McMillan, General Counsel, Investment Company Institute, to David A. Stawick, Secretary, Commodity Futures Trading Commission, dated January 11, 2011 (“January Letter”).

⁶ The interpretation in the proposal permitting the CFTC to impose position limits “prophylactically” should be harmonious with, and not supplant, the “appropriateness” determination required by the Dodd-Frank Act.

person or class of persons...from any requirement it may establish under this section with respect to position limits.”⁷ Yet the proposal does not even consider whether different limits are appropriate for different groups or classes of persons, such as funds.⁸ Funds, which are widely held and extensively regulated, do not raise the concerns for which the Dodd-Frank Act permits position limits to be imposed and regulation of their positions would not, therefore, be “appropriate.” To the contrary, as discussed below, regulation of funds’ market positions likely would dampen liquidity, hinder price discovery, limit transparency and foreclose certain investors’ access to the futures and swaps markets – ironically, the specific concerns underlying the grant of authority to the CFTC in the Dodd-Frank Act to impose position limits.

A. Importance of Funds to Futures and Swaps Markets

Funds provide significant benefits to the futures and swaps markets by serving as a stable, long-term source of liquidity and facilitating efficient price discovery.⁹ In addition, funds provide small investors with access to the commodities market that may not otherwise be available to them. In so doing, funds provide these investors with a cost-effective means of investing in the commodity markets that may provide important portfolio diversification, inflation hedging, and risk mitigation benefits.

⁷ Several legislators have voiced their support for an exclusion from position limits for trading activity that would include the type of trading undertaken by funds – *i.e.*, trading that is unleveraged, transparent, exchange-traded, clearing-house guaranteed, and poses no systemic risk to the clearing system. *See* Senate floor statement, Senator Blanche L. Lincoln (D-AR), Chairman, Senate Committee on Agriculture, Nutrition, and Forestry (July 15, 2010). *See also*, Letter from Congressman Spencer Bachus (R-AL), Ranking Member, House Committee on Financial Services, and Congressman Frank Lucas (R-OK), Ranking Member, House Committee on Agriculture, to Timothy Geithner, Secretary, The Department of the Treasury, Mary Schapiro, Chairman, Securities and Exchange Commission, Gary Gensler, Chairman, Commodity Futures Trading Commission, and Ben Bernanke, Chairman, Federal Reserve, dated December 16, 2010, and Letter from Senator Blanche L. Lincoln (D-AR), Chairman, Senate Committee on Agriculture, Nutrition, and Forestry, to Gary Gensler, Chairman, Commodity Futures Trading Commission, dated December 16, 2010.

⁸ *See* Opening Statement, Open Meeting on the Ninth Series of Proposed Rulemakings under the Dodd-Frank Act, Commissioner Jill E. Sommers, January 13, 2011. Instead of examining the different types of derivatives traders, the CFTC focuses solely on providing uniform position limits across trading venues for all economically equivalent derivatives.

⁹ Studies have shown that diversified, unleveraged funds that take passive, long-only positions did not cause a speculative bubble or price volatility in commodities from 2005 to 2008. *See* Letter from Timothy W. Cameron, Managing Director, Asset Management Group, Securities Industry and Financial Markets Association, to David A. Stawick, Secretary, Commodity Futures Trading Commission, dated November 23, 2010 (referencing 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.”) and October 2008 IMF World Economic Outlook). *See also*, Opening Statement, Public Meeting on Proposed Rules Under Dodd-Frank Act, Commissioner Michael V. Dunn, January 13, 2011 (“Price volatility exists in markets that have position limits and in markets that do not have position limits. Price volatility exists in markets that have substantial participation from index funds and markets that do not have any index fund participation whatsoever.”).

As discussed in our January Letter, funds that invest in the futures and swaps markets are investing on a long-term basis to replicate the return in these markets and should be distinguished from speculators, which take a directional view on the prices of certain commodities.¹⁰ Generally, funds do not selectively target particular physical commodities or amass significant positions in any one commodity, like silver or oil, such that their selling decisions could affect market pricing. Rather, funds invest in a basket of commodities, without focusing on any particular market. Additionally, many of these funds do not hold positions in the delivery month, which reduces their possible impact on price convergence during the time when concerns over price volatility have traditionally been the greatest. Further, because of the nature of these funds that seek to track the return of a commodity index, their trading represents liquidity and market depth, which might not be the case for an individual market speculator that actively trades in and out of the market.

In the proposal, the CFTC justifies the imposition of position limits on the basis of preventing sudden or unreasonable price fluctuations attributable to large speculative positions, even without manipulative intent.¹¹ It explains that more “evenly distributed” investment in the commodity markets would reduce the likelihood that one or a few traders holding a substantial position will be able to unduly influence the price of any one commodity. Funds, however, provide this broadly distributed investment in the commodities market. They aim to mirror the performance of the underlying commodity markets by benchmarking to an index. The size of their positions is largely determined more by the performance of the index and individual investors moving in and out of the fund than by independent, active investment decisions, meaning changes in positions typically occur in small amounts versus large volatile swings. These funds are no more likely or capable of engaging in excessive speculation or price manipulation than the individual investors themselves.

Imposing position limits on funds could harm the futures and swaps markets as well as fund investors in those markets. Position limits could reduce the liquidity available to commodity producers and end-users if funds, which often take the other side of producers’ and end-users’ trades, were no longer able to participate in the markets. Reducing liquidity would impair price discovery as well. Fewer traders, and consequently transactions, in the commodities derivatives markets would result in less transparency and information to identify the true market price of a contract. In addition, depriving these markets of the stability afforded by funds’ long-term investments could increase volatility, impairing confidence and further dampening liquidity.

The imposition of position limits also would impair an important portfolio diversification tool for fund investors. Complying with position limits could have the adverse result of forcing liquidations when position limits are approached. Such liquidations could create tax consequences and, if funds were forced to trade at unattractive prices, significantly disadvantage fund shareholders.

¹⁰ See January Letter, *supra* note 5.

¹¹ The Dodd-Frank Act uses the term “excessive speculation” instead of “large speculative positions.”

B. Stringent Regulation of Funds

Funds are registered under the Investment Company Act, which imposes stringent regulation on funds that is not imposed on other financial institutions or products under the federal securities laws. In our January Letter, we described in detail how these measures prevent excessive speculation and market manipulation and ensure that funds do not contribute to systemic risk and are not too heavily concentrated in one investment.¹² We continue to believe that the rigorous regulatory regime imposed on funds by the Investment Company Act provides an additional, and very important, justification for an exemption for funds under any position limit rules adopted by the CFTC.

Limitations on leverage. Funds are subject to significant limitations on their ability to use leverage, limiting their ability to cause or contribute to systemic risk. Under Section 18 of the Investment Company Act and later Securities and Exchange Commission (“SEC”) and staff guidance, a fund is prohibited from taking on a future obligation to pay unless it “covers” the obligation by setting aside, or earmarking, assets sufficient to satisfy the potential exposure from the derivative transaction.¹³ The assets used for “covering” such obligations must be liquid, marked to market daily, and held subject to the SEC’s custody rules.¹⁴

Requirements for custody of investment securities. Under Section 17(f) of the Investment Company Act, funds must “place and maintain” their assets in the custody of a bank or, subject to certain SEC rules, a member of a national securities exchange or the fund itself.¹⁵ In particular, Rule 17f-6 under the Investment Company Act explains how assets should be maintained in connection with commodity derivatives contracts to safeguard funds’ investment securities.

Limitations on exposure to certain counterparties; Diversification. Under Section 12(d)(3) of the Investment Company Act, funds’ exposure to securities of securities-related businesses are subject to certain percentage limitations. Because derivatives counterparties are typically securities-related businesses, many funds interpret this section as imposing a 5 percent limit on the fund’s total assets that may be invested in derivatives with any single counterparty. Further, funds electing to be “diversified companies” under the Investment Company Act must invest at

¹² See January Letter, *supra* note 5.

¹³ Under certain circumstances, a fund may also enter into transactions that offset the fund’s obligations. See Dreyfus Strategic Investing and Dreyfus Strategic Income, SEC No-Action Letter, Fed. Sec. L. Rep. (CCH) 48,525 (June 22, 1987).

¹⁴ See Merrill Lynch Asset Management, L.P., SEC No-Action Letter, 1996 WL 429027 (July 2, 1996) and Investment Company Act Release No. 10666 (April 18, 1979), 44 FR 25128 (April 27, 1979).

¹⁵ As a practical matter, most funds’ assets are maintained with a bank custodian.

least 75 percent of their total assets in cash and securities and, within this 75 percent of assets, may not invest more than 5 percent of total capital in any single issuer.¹⁶

Other requirements. Funds are subject to rigorous disclosure requirements, including disclosure of their investment objectives and policies, the concentration of investments in any particular asset class or industry, and their net asset values. Funds also are obligated to maintain comprehensive compliance programs to ensure that all of these obligations are fully met to protect investors and the markets.

II. Adoption of Proposed Position Limits Premature

Notwithstanding ICI's recommendation for an exemption for funds from any position limits adopted by the CFTC, we are concerned that the proposed imposition of position limits across the commodities derivatives markets is premature. ICI understands that the CFTC is in a difficult position, having been directed by Congress in the Dodd-Frank Act to establish, as appropriate, such limits. Yet the CFTC has acknowledged in its proposal that it currently has insufficient data regarding swap market positions or participants to determine the appropriate formula for position limits.¹⁷ Indeed, the proposal uses a broad one-size fits all approach that fails to reflect the differences in liquidity and systemic risk that exist between different users of commodity derivatives. Further, there is not presently enough infrastructure with respect to swaps positions for limits to be effectively established or reasonably enforced. With all of these "unknowns," we recommend that the CFTC delay action on its proposal until after it has had an opportunity to gather and analyze sufficient data to justify the costs, burdens, and potential unintended consequences of the proposal.¹⁸

We are concerned that without additional study and analysis supporting the imposition and levels of the proposed position limits, the CFTC's proposal could significantly harm the commodity markets. In addition to the potential negative consequences to these markets of imposing position

¹⁶ See Section 5 of the Investment Company Act.

¹⁷ See also, Remarks before the Institute of International Bankers, Annual Washington Conference, Jill E. Sommers, Commissioner, Commodity Futures Trading Commission, March 7, 2011 ("We proposed these aggregate position limits for futures, options and swaps despite the fact that we lack data on the size of the swaps markets. In the absence of reliable data, I do not believe that we are in a position to set effective limits.").

¹⁸ Several CFTC Commissioners questioned whether sufficient economic data exists to support the claims that position limits curb excessive speculation or that excessive speculation exists in the commodity futures and swaps markets. See, e.g., Opening Statement, Public Meeting on Proposed Rules Under Dodd-Frank Act, Commissioner Michael V. Dunn, January 13, 2011 ("To date, CFTC staff has been unable to find any reliable economic analysis to support either the contention that excessive speculation is affecting the markets we regulate or that position limits will prevent speculation."), and Statement, Prior to Notice of Proposed Rulemaking – Position Limits for Derivatives, Commissioner Scott D. O'Malia, January 13, 2011 ("I do not believe the absence of position limits has had any impact on prices in the past, and I do not believe that setting them now will be effective in preventing a barrel of oil from going over \$100/barrel.").

limits on funds, discussed above, the proposed position limits could limit the ability of bona fide hedgers to hedge and reduce risk; impair price discovery; increase trading costs; and dampen liquidity in U.S. markets by driving it to jurisdictions that do not have such limits. At this time, most non-U.S. jurisdictions do not have hard position limits for derivatives.¹⁹ Without corresponding undertakings by other nation's regulators, imposing limits in the United States could encourage a migration of liquidity to these foreign jurisdictions, adversely affecting price discovery, efficient hedging, and the competitive position of U.S. entities and hindering efforts to improve transparency in the commodities derivatives markets.²⁰

ICI therefore recommends the following road map for adopting position limits. The CFTC should first gather market and trading information to determine: (1) whether position limits are "appropriate" for the futures and swaps markets generally; and (2) whether position limits are "appropriate" for funds and other types of investors participating in these markets. After analyzing such data, the CFTC should propose, if appropriate, position limits for the different classes of market participants, making such proposals available for public comment. Any determinations regarding the appropriateness of position limits should then be coordinated with international efforts to ensure that trading does not shift offshore. Adoption of position limits, if any, should have staggered effective dates to avoid significant disruptions to trading in the futures and swaps markets.

III. Concerns with Proposed Position Limits

If the CFTC determines to proceed with its proposal, without providing an exemption for funds, we recommend that it address concerns relating to, among others, aggregation requirements, the definition of bona fide hedging, and the position limits formula, to ensure that any position limits adopted by the CFTC are carefully tailored to address conduct that may contribute to concerns about speculation without unduly harming the commodity futures and swaps markets.

¹⁹ Some jurisdictions have voiced opposition to position limits in the derivatives markets while others are exploring the issue. See "EU to call for commodity derivatives curbs," FT.com, Nikki Tait and Peggy Holinger, February 2, 2011. The European Commission, for example, is proposing only to give regulators in member countries the option of setting position limits, and suggesting they confine such limits to agricultural commodities.

²⁰ In early 2010, the rhetoric regarding the possible imposition of position limits on swap dealers and index funds in the energy markets without allowance for exemptions began pushing these participants to transact in exempt-over-the-counter swap markets, foreign exchanges with less restrictive or non-existent position limits requirements, and even domestic securities markets. See CME Group White Paper: Excessive Speculation and Position Limits in Energy Derivatives Markets, dated September 16, 2009. Adoption of position limits across the commodity markets likely would have an even greater "push out" effect.

A. Aggregation and Independent Account Exemption

As we recommended in our January Letter, the CFTC should permit disaggregation among funds in calculating positions under any rules it adopts.²¹ In the proposal, the CFTC links the size of a position to the size of the holder of the position and explains that limits are necessary to counter price distortions caused by the creation and liquidation of large concentrated positions. The proposal does not recognize the unique structure of funds or their relationship with fund advisers such that an adviser has many fund interests folded into its position. Instead, advisers should report the positions of each of their clients separately and should not be required to aggregate the positions of any fund with the positions of other funds managed by the same adviser or its affiliates.

The size of a fund's positions typically is not controlled by the adviser but by the investors that move into and out of the fund, so coordination between funds for purposes of manipulation and speculation is inapposite. Moreover, each fund is a separate client of a registered investment adviser, with a separate group of investors and independent investment objectives.²² As a fiduciary, advisers to these funds must make decisions based on the objectives and needs of each individual fund without taking into account other funds' positions. Accordingly, there is no reason to believe that funds managed by the same adviser or its affiliates would inappropriately engage in manipulative trading activity.

Similarly, ICI recommends the CFTC should maintain its independent account controller exemption under existing CFTC regulations for both financial and non-financial entities.²³ Eliminating this exemption for financial entities²⁴ and narrowing it for non-financial entities would present operational and legal challenges to funds and fund advisers. For example, systems and procedures would need to be developed to collect, assess, and continually monitor positions across companies, countries, and funds that currently operate independently. It also would disregard the important safeguards that fund managers have established to prevent inappropriate sharing of

²¹ See January Letter, *supra* note 5. In the same Senate floor statement discussed above, then Agricultural Committee Chairman Blanche Lincoln said, "Further, I would encourage the CFTC to consider whether it is appropriate to aggregate the positions of entities advised by the same advisor where such entities have different and systematically determined investment objectives." See *supra* note 7.

²² With a few exceptions not relevant here, the marketplace and the SEC apply the provisions of the federal securities acts to funds at the individual fund level, treating individual funds and series funds as if the separate portfolios were separate investment companies. See *Legal Considerations in Forming a Mutual Fund*, Philip H. Newman, ALI-ABA Course Materials, June 2010.

²³ See CFTC Rule 150.3(a)(4) (providing an exemption from aggregating positions of separate funds when trading is controlled by independent decision-makers).

²⁴ "Financial entities" would include, among others, financial institutions, insurance companies, investment companies, investment advisers, and commodity pools.

information and could also create potential conflicts of interest that these safeguards have been designed to eliminate.

Quite simply, when two or more “independent account controllers” (*i.e.*, advisers) trade for the same fund (*e.g.*, “multi-adviser fund”), the advisers’ fiduciary obligation requires that they trade independently of each other. They cannot reasonably be viewed as a single speculative trading entity that is trading in concert or tying jointly to affect prices. Likewise, when any adviser’s trading is independent from that of its affiliates or parent, it distorts economic reality and interferes with proper corporate governance to combine together the adviser, its affiliates, and its parent, as a single trader or treat them as if they were trading in concert.

B. Definition of Bona Fide Hedging

The proposal would narrow the definition of “bona fide hedging” to incorporate risk-reducing transactions or positions only if such transactions or positions represent a substitute for cash market transactions, and offset cash market risks. This interpretation would differ from the current recognition of bona fide hedging transactions or positions under CFTC Rule 1.3(z) as a risk-reducing activity that “normally,” but not necessarily, represents a substitute for cash market transactions or positions, thereby precluding financial hedging. We urge the CFTC to define “bona fide hedging” as it is commonly understood in the investment industry to include a definition that encompasses both commercial and financial hedging, recognizing the risk-reducing function of these transactions.²⁵ Investors rely on funds to hedge their portfolio risk, including inflation and currency risks; these are not speculative transactions for which position limits are designed.

We strongly believe that including portfolio risk-reduction transactions within the scope of the definition of bona fide hedging is consistent with new Section 4a(c)(2) of the Commodity Exchange Act, as modified by the Dodd-Frank Act, despite the omission of “normally” from the definition. We believe that the House of Representatives inserted the commercial hedging provision in Section 737 of the Dodd-Frank Act to ensure that new regulations did not eliminate or limit traditional end-users’ and other physical market participants’ access to the hedging exemption.²⁶ There is no record that the

²⁵ This common understanding also is reflected in the CFTC’s instructions regarding disclosure of hedge 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 funds as well as producers and manufacturers. *See* CFTC Form 40, Statement of Reporting Trader, Part B, Item 3 and Schedule 1.

²⁶ The language regarding the physical market transactions originated in the House Committee on Agriculture, chaired by Representative Collin C. Peterson. It was added to the House-passed version of the Dodd-Frank Act, in the Peterson-Frank amendment, which also exempted commercial end users from swaps clearing requirements. It was not a part of the House Finance Committee, Senate or Treasury version of the Dodd-Frank Act. *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 (December 10, 2009).

language was meant to exclude other types of participants from the hedging exemption or alter the CFTC's definition or the common understanding of bona fide hedging. Accordingly, we recommend that the CFTC follow Rule 1.3(z)(1) to define bona fide hedging for purposes of the exemption to encompass a broad range of transactions that offset other risks, regardless of whether the hedger is a physical market participant or whether the risk hedged is commercial or financial.²⁷

C. Position Limits Formula

The formula for calculating position limits should be modified. In the proposal, the CFTC states that certain of the proposed limits are designed to be high to ensure sufficient liquidity for bona fide hedgers and to avoid disrupting the price discovery process "given the limited information the [CFTC] has..." The CFTC also acknowledges that "market data can support a range of acceptable speculative position limits" and that it "requires additional, reliable, and verifiable swaps data..." Given these acknowledgements of the uncertainty of the appropriate level of position limits, we recommend that the CFTC eliminate the proposed cap (10 percent of the first 25,000 contracts of open interest, and 2.5 percent thereafter) in its formulas for non-spot months, retaining a trigger of no less than 10 percent of open interest, until it is able to gather and assess data regarding market positions. It may be even more appropriate to apply limits higher than 10 percent for non-spot month contracts until such time as the requisite market data is available. In line with the CFTC's concern, this actually would help to minimize unintended consequences and market disruptions until such time as the CFTC has a credible understanding of the true risk of excessive speculation in the commodity markets.

D. Netting

The proposal would not permit netting of physical delivery and cash settled contracts for purposes of determining compliance with the proposed aggregate and single-month limits. Netting is critical to preserving liquidity and presenting an accurate picture of commodity market positions. Without netting, the proposed limits are set at levels so low they will significantly reduce dealers' ability to provide liquidity to each other and to clients, including funds. The spot-month limits, including those for cash-settled contracts, are based on the "estimated deliverable supply" of each commodity, as determined by the relevant designated contract market. Estimated deliverable supply should not form the basis for setting a limit on those positions because it is not relevant to cash-settled contracts. In addition, no systematic, rigorous process for determining estimated deliverable supply exists, and the designated contract markets have not made their current determinations of estimated deliverable supply publicly available. There is significant uncertainty in the derivatives market as to how this crucial concept, on which the entire spot-month limit infrastructure is based, would be defined and

²⁷ The CFTC has clarified that balance sheet and other commonly used 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 CFTC Release, *Clarification of Certain Aspects of the Hedging Definition*, 52 FR 27195 (July 20, 1987).

thus how spot-month limits would be set. We recommend that the concept of estimated deliverable supply be studied further before being implemented to avoid significant market disruption.

IV. Phase-In Position Limits

As discussed above, the CFTC does not have adequate data to determine the necessity of or appropriate formulas for position limits in the commodity markets. Likewise, it does not have data to determine the effects of its proposed position limits on these markets. As a result of this lack of information, the CFTC has proposed to phase in certain position limits by relying on designated contract market spot-month limits until such time as it can determine its own spot-month limits after reviewing market data. In addition to the CFTC's proposed two-step process, we recommend that the CFTC stagger the effective dates for compliance with any appropriate position limits that are adopted for each of the different categories of commodities derivatives to avoid significant disruptions to trading in these markets.

V. Position Points Inappropriate

ICI is deeply concerned about the manner in which the CFTC has implemented its "position points" regime. The "position points" directive, as described by CFTC Chairman Gensler in his statement concerning the position limits proposal, requires the CFTC staff to exercise heightened surveillance of large positions and gives the CFTC discretion to take action to limit the size of positions any market participant may hold if it exceeds the "position point," as determined by a majority of the Commission.²⁸ While we strongly support the CFTC's efforts to gather data before fully implementing its position limits proposal, we question whether there is sufficient authority to enforce "position points" absent a notice and comment rulemaking process similar to the one the CFTC is undertaking for position limits. Moreover, we are concerned that the criteria for when the CFTC may elect to enforce "position points" is vague, uncertain, and may conflict with parts of the position limit proposal, which could adversely affect market participants' interest in participating in the derivatives markets and thereby reduce market liquidity. We strongly urge the CFTC to adopt the recommendation of Commissioner O'Malia to refrain from exercising enforcement of "position points" without providing the public an opportunity to provide input.²⁹

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²⁸ Statement on Support of the Dodd-Frank Rulemaking of Chairman Gary Gensler, January 13, 2011.

²⁹ We also would support either of Commissioner O'Malia's other recommendations in lieu of the present course of action, which appears to set position limits absent the requirements of the Administrative Procedure Act. *See* Statement, Prior to Notice of Proposed Rulemaking – Position Limits for Derivatives, Commission Scott D. O'Malia, January 13, 2011.

Mr. David A Stawick

March 28, 2011

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If you have any questions on our comment letter, please feel free to contact me directly at (202) 326-5815, Heather Traeger at (202) 326-5920, or Ari Burstein at (202) 371-5408.

Sincerely,

/s/ Karrie McMillan

Karrie McMillan
General Counsel

cc: The Honorable Gary Gensler, Chairman
The Honorable Michael V. Dunn, Commissioner
The Honorable Jill E. Sommers, Commissioner
The Honorable Bart Chilton, Commissioner
The Honorable Scott D. O'Malia, Commissioner