INSTITUTE FOR AGRICULTURE AND TRADE POLICY

Comment in response to petition to the Commodity Futures Trading Commission for exemptive relief regarding "Aggregation, Position Limits for Futures and Swaps," 17 CFR Part 151 (RIN 3038-AD82) (Federal Register, pp. 31767-31783)

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June 29, 2012

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Overview

IATP is grateful for the opportunity to share its views on questions posed by the Commodity Futures Trading Commission as it considers how to respond to the Commercial Energy Working Group ("Working Group") petition for an exemption from the Part 151 rule regarding positions limits that requires aggregation of data on positions held in futures, options and swap contracts.1 As the Commission notes in its position limits rule, "In light of the importance of aggregation standards in an effective position limits regime, it is critical that the Commission effectively and efficiently monitor the extent to which traders rely on any of the disaggregation exemptions."2 The requested exemption from aggregation would apply to all owned non-financial entities (i.e. entities that own 10 percent or more of a non-financial entity, subject to a demonstration of the independence of control of non-financial entity trading positions), including agricultural ones. IATP is among many analysts and scholars who believe that passively invested energy contract dominant commodity index funds and related instruments disrupt agricultural price formation based on fundamental factors.3

IATP is therefore concerned that effective implementation of CFTC position limit rules to prevent excessive speculation on agricultural commodity contracts will be impeded if the proposed Working Group exemptions from aggregation of trading data are granted. Although the Commission estimates that just ninety entities will be affected by the filing requirements for the proposed amendment to the Position Limits Rules (FR 31781), these entities include the Designated Contract Markets, swaps execution facilities, Foreign Contract Markets, foreign brokers and large traders (FR. 31780). These entities will have the resources to apply for and received the proposed exemptions from aggregation.

General Comment

The petition requests an exemption from aggregation for all owned non-financial entities, as well as the Commission's "clarification" of Part 151 to ensure that aggregation not result in potential (though mostly unspecified) violations of local, state, federal and international law. The Commission's review of the Working Group petition will be based apparently on a compromise between ensuring the aggregation of sufficient data to enable the Commission's data surveillance and enforcement of the Position Limits Rule, and containing the costs of compliance with aggregation rules and exemptions: "The Commission intends for the proposed rules to preserve the important protections of the existing aggregation policy, but at a lower cost for market participants" (FR, 31779). For example, the Commission proposes to exempt from aggregation filing the "higher-tier" entities that own the non-financial entities most at risk of circumventing position limits, in order to avoid duplicative aggregation filing costs (FR 31778-31779).

Because the Commission presents a credible estimate of the costs of aggregation reporting by the regulated entities (FR 31781, including footnote 120), we have confidence in the Commission's estimates of the cost to industry of aggregation filing. We do not believe the hortatory claims in the Working Group petition that a vast new information infrastructure will be required to implement the Position Limit Rule, which the petitioner characterizes as "impossible to implement without market distortions" (11). Subject to owned non-financial entity compliance with the documentation requirements for filing an aggregation exemption, we believe that the Commission's compromise between comprehensive and timely aggregation and cost reduction in aggregation filing can be achieved in the proposed "higher tier" exemption.

However, the petitioner's "clarification"proposes an exemption from aggregation, in the case that aggregation poses a "reasonable risk" of potential violations of local, state, federal and/or international law (FR 31769-31770). This proposed exemption is of a completely different order and magnitude than the exemption sought to avoid duplication of costs in aggregation exemption filing. Despite the Commission's proposed requirement that the applicant for the exemption present a legal opinion documenting the "reasonable risk" of potential violation argument (FR, 31771), we do not believe that this exemption can be implemented in a way that would be consistent and fair to all market participants, and that would enable effective implementation of the Position Limit Rule.

The Commission rightly requests examples from commenters concerning anticipated potential violations. Yet even if these examples provided suggestive, though not probative, evidence of "reasonable risk" of potential violations of law due to aggregation requirements, would the Commission have the resources and authority to determine actual violations of law resulting from aggregation requirements? Would the Commission grant an exemption from aggregation when no law was violated, and if so, for how long, and for which market participants? Would laws have to be modified to remove the possibility of "reasonable risk" of violation? Given the hypothetical evidentiary requirements for receiving the exemption, why wouldn't all market participants file for aggregation exemptions on the basis of hypothetical violations of myriad laws?

The petitioner contends that the sharing of marketing information by independent entities in a joint venture (8-9) in violation of U.S. anti-trust law is comparable to the aggregation of position data among regulated entity and its affiliates. As we understand it, once aggregation standards are agreed, aggregation is an automated process, in which the opportunity for time-sensitive collusion in violation of anti-trust laws is minimal to non-existent. We are not persuaded by the petitioner's example of potential violations and hope that any exemption that the Commission may grant to aggregation would be on the basis of the likely violation of U.S. federal law, informed by a history of violations that actually occurred due to aggregation activities.

Finally, the Commission asks whether a proposed exemption should be granted on the basis of

“reasonable risk” of potential violation of “international law” or that of the “law of a foreign jurisdiction” (FR, 31772). “International law” affecting financial services is contained within the World Trade Organization’s General Agreement on Trade in Services, the WTO’s Understanding on Financial Services, and provisions of free trade agreements and bilateral investment treaties. All these agreements have dispute settlement mechanisms to make their provisions binding, whereas the Financial Stability Board and the International Organization of Securities Commissions issue non-binding recommendations on best practices in regulation and policy. None of these agreements enables the extra-territorial application of Dodd-Frank, including the application that pertains to data aggregation and position limits. That extra-territorial application would result from revisions to the CFTC’s bilateral Memoranda of Understanding with competent regulatory authorities in each jurisdiction. Hence if the Commission decides to issue an aggregation exemption rule on the basis of potential violations, the term “law of a foreign jurisdiction is preferable.

Further extra-territorial considerations of the proposed aggregation exemptions

As the Commission deliberates whether to use its authority to grant the Working Group’s petition, it should consider how the exemption will affect the aggregation of trade data necessary to achieve both the objectives of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) and the Group of 20 Heads of State commitments to bringing transparency to the trading of Over the Counter derivatives. It cannot be repeated too often or too loudly that near total lack of OTC pre and post-trade data transparency was a main driver of the near collapse of the global financial system in 2008. The $29 trillion Federal Reserve emergency loan rescues to EU and U.S. banks from 2007-2010[4] to keep the system from collapsing likely will be in vain if the vast majority of trade data continues to be unreported and hence dark both to regulators and to the public, or reported but disaggregated .

The mere reporting of OTC trades to trade data repositories will not suffice to prevent another financial crisis, no matter how much computer technology the Commission and other regulatory authorities have to gather that data. If that data is not consistently and comprehensively aggregated for commodity contract position limits and for instruments of other asset classes, no timely analysis of the data can occur and hence there can be no effective surveillance or enforcement. This view, presented in much greater detail in an August 2011 report of the Committee on Payments and Settlement Systems of the Bank for International Settlements and the International Organization of Securities Commissions for the G-20 finance ministers,[5] should be an important guide for the Commission in its deliberation on the Working Group’s petition.

Conclusion

In our view, the Commission’s sole exemption from aggregation requirements in the position limit rule, the “Exemption for federal law information sharing restriction,”[6] provides broad protection for entities concerned that aggregating trade data from their affiliates may expose them to charges that they have violated laws on anti-competitive business practices. As noted above, we are not persuaded by the examples of anti-trust violation adduced by the petitioner. If the Commission decides to retain the aggregation exemption on the basis of “reasonable risk” of potential violation of laws, we urge the Commission to restrict that exemption to like violations of U.S. federal law. We further urge the Commission to specify criteria that a legal opinion on likely violations of U.S. federal law would have to meet to be able to file the application for exemptive relief.

The Commission’s exemption from position limit rule requirements for bona fide hedging of commercial risks[7] should provide energy firms and other commercial hedgers with sufficient regulatory flexibility to manage their contract price risks. Granting the Working Group exemption for all “owned non-financial entities” would provide the opportunity for the non-commercial counterparties to swaps with the owned non-financial entities to continue to flood the market with liquidity

far in excess of the needs of commercial hedgers. The resulting excessive speculation would violate the letter and the spirit of the Commodity Exchange Act as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank). We urge the Commission to restrict the exemption for owned non-financial entities to the "higher tier" entities in order to avoid duplicative aggregation filing and their associated costs.

IATP wishes to thank the Commission for its consideration of these brief remarks on proposed exemptions to aggregation.

Endnotes

1 http://www.cftc.gov/stellent/groups/public/@rulesandproducts/documents/ifdocs/wgap011912.pdf

2 "Position Limits for Futures and Swaps," Commodity Futures Trading Commission, Federal Register, 76:223 (November 18, 2011), 71679. http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-28809a.pdf

3 For a bibliography of about a hundred recent academic and non-governmental organization studies on excessive speculation, see http://www2.weed-online.org/uploads/evidence_on_impact_of_commodity_speculation.pdf

4 James Felkerson, "$29,000,000,000,000: A Detailed Look at the Fed's Bailout by Funding Facility and Recipient," Working Paper No. 698, Levy Economics Institute, December 2011. http://www.levyinstitute.org/publications/?docid=1462

5 "Report on OTC Derivatives Trading Reporting and Aggregation Requirements dated August 2011," 3. Better Markets, Inc. September 23, 2011. http://www.bettermarkets.com/sites/default/files/CPSS-%20IOSCO-%20CL-%20OTC%20Derivatives%20Data%20Reporting%209-23-11.pdf

6 "Position Limits for Futures and Swaps," Section 151.7 (i), 71693.

7 "Position Limits for Futures and Swaps," Section 151.5: Bona fide hedging and other exemptions for Referenced Contracts.