



Commodity Markets Council
1300 L St., N.W. Suite 1020
Washington, DC 20005
Tel 202-842-0400
Fax 202-789-7223
www.commoditymktcs.org

December 12, 2013

Mr. Gary Barnett
Director, Division of Swap Dealer and Intermediary Oversight
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, D.C. 20581

Mr. Jonathan Marcus
General Counsel
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, D.C. 20581

Mr. Vincent A. McGonagle
Director, Division of Market Oversight
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, D.C. 20581

**Re: Request for Interpretive Guidance – Rule 1.35 Contained Within the
Final Rules on Adaptation of Regulations to Incorporate Swaps – Records
of Transactions**

Dear Messrs. Barnett, Marcus, and McGonagle:

The Commodity Markets Council (“CMC”) respectfully requests that the Division of Swap Dealer and Intermediary Oversight, the Office of the General Counsel, and the Division of Market Oversight of the Commodity Futures Trading Commission (the “CFTC” or the “Commission”) issue interpretive guidance concerning the application of the electronic recordkeeping requirements of CFTC Rule 1.35 (“Rule 1.35”) to certain cash market transactions. In particular, CMC respectfully requests that the Commission issue guidance interpreting the requirement to retain records of electronic communications that “lead to the execution of a transaction in a commodity interest and related cash or forward transactions” as inapplicable to members of CFTC-designated contract markets (“DCMs”) or swap execution facilities (“SEFs”) unless the member is otherwise registered and acting on behalf of a customer for which the futures contract, swap, or commodity option¹ is held.

I. CMC’s Interest in Seeking Interpretive Guidance

CMC is a trade association that brings together exchanges and their industry counterparts. The activities of our members represent the complete spectrum of commercial end-users of all futures markets, including energy and agriculture. Specifically, our industry member firms are regular users, and many are members, of such DCMs as the Chicago Board of Trade, Chicago Mercantile Exchange, ICE

¹ CFTC Rule 1.3(yy) defines “commodity interest”, in relevant part, to mean “(1) Any contract for the purchase or sale of a commodity for future delivery; (2) Any contract, agreement or transaction subject to a Commission regulation under section 4c or 19 of the Act; . . . and (4) Any swap as defined in the Act, by the Commission, or jointly by the Commission and the Securities and Exchange Commission.”

Futures US, Kansas City Board of Trade, Minneapolis Grain Exchange and the New York Mercantile Exchange. In addition, they will be users, and many will become members, of SEFs. As a result, CMC is well positioned to provide the consensus views of commercial end-users of derivatives on the impact of the Commission's regulations on their commercial operations. Our comments represent the collective view of CMC's members.

II. The Requirement to Retain Pre-Trade Electronic Communications

Rule 1.35(a)(1) provides, in relevant part, that members of DCMs or SEFs must maintain records of:

all oral and written communications provided or received concerning quotes, solicitations, bids, offers, instructions, trading, and prices *that lead to the execution of a transaction in a commodity interest and related cash or forward transactions*, whether communicated by telephone, voicemail, facsimile, instant messaging, chat rooms, electronic mail, mobile device, or other digital or electronic media; Provided, however, the requirement in this paragraph (a)(1) to record oral communications shall not apply to:

- (i) Oral communications that lead solely to the execution of a related cash or forward transaction;

Although many CMC members are members of DCMs and will become members of SEFs, they are not otherwise required to be registered with the Commission. Therefore, pursuant to Rule 1.35(a)(1)(viii), they are exempt from the requirement to record oral communications.² Nevertheless, CMC's membership does not have a clear understanding of, and has concerns about, the scope of Rule 1.35's requirement to retain written communications made via "digital or electronic media" that "lead to the execution of transactions in a commodity interest and related cash or forward transactions."

Unless the Commission provides the interpretation requested herein, CMC members will be forced to either withdraw from or forego membership in DCMs and SEFs, or, out of an abundance of caution, spend significant amounts of time and resources in a commercially impractical attempt to capture all electronic communications related to virtually all of their cash market transactions.

III. The Commercial Problems Raised by the Requirement to Retain Electronic Communications

There are at least two fundamental problems with the requirement to retain records of pre-cash market transaction written communications. First, in today's marketplace, text messaging, instant messaging and similar electronic communications have replaced telephone conversations as the primary mode by which commercial agriculture and energy companies communicate with producers, processors, merchants and commercial users of commodities. Although the Commission exempted non-registered members of DCMs and SEFs from the requirement to retain records of telephone conversations, the usefulness of the exemption is diminished by the requirement that commercial companies retain records of the methods of communication that have supplanted the telephone. CMC members have not been able to find technology that enables searches of digital or electronic media that is not cost-prohibitive.³

² Rule 1.35(a)(1)(viii) provides that "the requirement in this paragraph [1.35](a)(1) to record oral communications shall not apply to...a member of a designated contract market or swap execution facility that is not registered or required to be registered with the Commission in any capacity."

³ Most burdensome and of particular concern is the requirement that all written electronic communications, including instant message and text message communications, must be retained and archived. The costs associated with compliance of both the written and oral recording requirements are exponentially higher than the estimates contained in the final rule and, in some instances, the necessary technology is unavailable entirely.

Second, the requirement to retain records of pre-trade communications “that lead to the execution of a transaction in a commodity interest and related cash or forward transactions” does not comport with the manner in which commercial agriculture and energy companies typically transact. The Commission has recognized that commercial companies use commodity interests to hedge the exposure of a portfolio of cash market transactions.⁴ They do not hedge on a contract-to-contract basis. As a result, they do not know when they enter into a cash market commodity transaction if it will be “related” to a commodity interest transaction. Consider the following examples:

Grain Company X has more than 100 facilities across the country. On any given day, it is buying and selling cash grain all across the country. The company does not buy and sell futures contracts to hedge each cash purchase or sale; instead, it determines its net cash market exposure (whether short or long), and then hedges that net exposure with futures contracts on a DCM.

Energy Company Y is in the business of contracting with upstream well owners and collecting crude oil from rural areas in Oklahoma, Texas, Kansas, New Mexico, Colorado and the Dakotas. Over the course of time, the Energy Company collects and stores a sufficient amount of crude oil to be delivered to refineries around the United States. As the Energy Company collects the crude oil and pays the well head producer for the crude oil the Energy Company runs the risk of declining crude prices and the possibility of a reduced sale price to the refiner. As such, the Energy Company makes dynamic decisions about the amount and timing of crude oil that will be hedged with futures or swap contracts. The decisions made to hedge the physical oil exposure is based upon a multitude of factors including how much crude oil is collected in a particular region, the difficulty of transportation from the field to the storage facilities, the difficulty of transportation from the storage locations to the refineries, the change in grade or quality of the crude oil required by the refineries and many other variables. As such, there is a tremendous amount of communication that goes on between well head producer, originators, marketers, transporters (truck and rail), terminal operators, refiners, traders and brokers.

CMC assumes that the Commission did not mean in Rule 1.35(a)(1) to require a company to record all electronic communications related to the buying and selling of the cash commodities that ultimately led to it hedging the net exposure of its portfolio of cash market transactions. No apparent public policy goal would be furthered by requiring commercial companies to retain records of written communications of a cash market transaction when the company cannot know at the time of such cash market transaction whether it will be part of the net exposure of the hedged portfolio.

IV. The Recordkeeping Requirement Should Not Discourage Membership in DCMs and SEFs

CMC believes that the Commission should encourage membership in DCMs and SEFs in order to further promote transparency in the marketplace and reduce costs for consumers of commodities. The application of the requirement to retain written records of pre-trade communications only to members

⁴ See, e.g., Position Limits for Futures and Swaps, 76 Fed. Reg. 71626 at 71649 (Nov. 18, 2011), noting the Commission’s recognition of commenters’ concerns with respect to portfolio hedging and intention to allow portfolio hedging (“[C]ommenters argued that if the Commission does not permit portfolio hedging, the requirement to one-to-one track physical commodity transactions with corresponding hedge transactions will increase risk by preventing end-users from effectively hedging their commercial exposure. The Commission intends to allow market participants either to hedge their cash market risk on a one-to-one transactional basis or to combine the risk associated with a number of enumerated cash market transactions in establishing a bona fide hedge, provided that the hedge is economically appropriate to the reduction of risk in the conduct and management of a commercial enterprise, as required under § 151.5(a)(1)(ii). The Commission has clarified this intention by adding after ‘potential change in the value of’ in § 151.5(a)(1)(iii) the phrase ‘one or several.’”).

of DCMs or SEFs has no apparent regulatory rationale and, in practical application, only serves as a disincentive to be a member of a DCM or SEF. CMC respectfully submits that the economic benefit of lower execution fees that comes with DCM and SEF membership should not come at the cost of having to invest considerable time and money in trying to comply with a rule that does not track commercial market practices.

CMC respectfully requests that the Commission clarify that the phrase "related cash or forward transactions" does not include cash market transactions that are aggregated on at least a daily basis and hedged on a portfolio basis with commodity interest transactions. This clarification would ensure that pre-trade communications concerning cash transactions that are not specifically related to commodity interest transactions executed on DCMs and SEFs are not subject to the costly requirements imposed by Rule 1.35(a)(1).

The interpretation requested herein will not diminish the Commission's ability to monitor and enforce compliance with the requirements of the Commodity Exchange Act. If the Commission provides the requested clarification concerning the requirement to retain written records of pre-trade communications, CMC members still will be required to retain records of executed transactions to the extent that they hold reportable futures or swaps positions. Those records should be sufficient for the Commission to fulfill its limited oversight function with respect to certain cash market transactions.

CMC supports the objectives of the Dodd-Frank Act as our members depend upon transparent and efficient derivatives markets to manage commodity market risks. Please contact me at Gregg.Doud@commoditymkt.org or by phone at (202) 842-0400 x 101, if you have any questions about CMC's request for interpretative guidance.

Sincerely,

A handwritten signature in black ink, appearing to read "Gregg Doud". The signature is fluid and cursive, with a long, sweeping tail on the final letter.

Gregg Doud
President
Commodity Markets Council