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GRESHAM INVESTMENT MANAGEMENT LLC

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COMMENT

Mr. David Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Proposed Risk Management Exemption From Federal Speculative Position Limits

Dear Mr. Stawick:

Introduction

Gresham Investment Management LLC ("Gresham") is pleased to submit these comments to the Commodity Futures Trading Commission (the "Commission" or "CFTC") on the proposed exemption for risk management positions in futures and futures equivalent option contracts on certain specified agricultural commodities (the "Proposal"). 72 Fed. Reg. 66097 (November 27, 2007).

Gresham is registered as a commodity pool operator and a commodity trading advisor under the Commodity Exchange Act, as amended (NFA Registration No. 0258100) and is also a registered investment adviser under the Investment Advisers Act of 1940, as amended. Gresham manages various funds and separate accounts pursuant to proprietary commodity investment programs. As of December 31, 2007, Gresham had approximately $4.5 billion of assets under management for its clients. Our clients include among others employee benefit plans, including state and local governmental plans, foundations and endowments, insurance company separate accounts, and governmental entities. Gresham's assets under management have increased rapidly in recent years and we anticipate continued significant growth in the future, due primarily to burgeoning interest by institutional investors worldwide in commodity investment programs involving fully collateralized, long-only futures positions. This development reflects the growing belief by institutional investors that commodities represent a separate asset class and that consistent exposure to commodities as an asset class can provide diversification for traditional equity and fixed income portfolios, as well as protection from inflation risk. In response to the growth in our business, Gresham requested and obtained no-action relief from the CFTC staff with respect to the applicable speculative position limits in corn, soybeans and wheat. See CFTC Letter

No. 06-19 (September 6, 2006). See also CFTC Letter No. 06-09 (May 5, 2006).

Discussion

Gresham supports the Proposal in concept, subject to the comments set forth herein. We agree that the Commission should add a risk management exemption applicable to a diversified commodity investment program which is rules-based and designed to maintain consistent exposure to commodities as an asset class on an unleveraged basis. However, we urge that the Commission modify certain of the proposed conditions for this exemption and clarify various other related points in connection with issuing final rule amendments. We also have responded to several of the specific questions on which the Commission is requesting public comments.

We wish to preface our detailed comments by addressing certain concerns that have been expressed by some commenters on the market impact of commodity futures trading by investment managers and other institutional market participants. First, there is no empirical evidence whatsoever that increased trading activity by institutional market participants has increased price volatility or adversely affected the functioning of the commodity futures markets as a price discovery and hedging mechanism. To the contrary, Gresham believes that the additional volume and open interest resulting from such trading activity has enhanced the liquidity of these markets and thereby reduced price volatility. Gresham also believes that these markets are sufficiently deep and liquid to absorb additional investment capital with ease.

Second, Gresham's rules-based, long-only, trading methodology is no more conducive to price manipulation or evasion of speculative position limits than any other nonspeculative strategy. As the Commission is aware, Gresham utilizes a predetermined set of mathematical rules and criteria for calculating the weightings for tangible commodity groups and individual commodities and for the annual reset and any rebalancings. Thus, Gresham resets the weightings annually based upon the economic significance and liquidity of each tangible commodity group in relation to all other tangible commodity groups, and of each commodity within a particular tangible commodity group in relation to all other commodities in such group, not on the basis of speculative market views, price targets, or price trends. Similarly, any periodic rebalancing is implemented in accordance with a predetermined numerical threshold and not on the basis of speculative market views, price targets, or price trends. Moreover, Gresham's trading activity is unleveraged and we do not carry positions into the spot month. Gresham and other investment managers who manage fully collateralized long futures positions in a systematic way roll their positions into later contract months prior to the last trading day or first notice of delivery day, whichever is earlier, and thus have no impact on the convergence of physical and futures prices during the delivery period and are also not responsible for high commodity prices.1 In sum, Gresham believes that these concerns are misplaced and reflect a fundamental misunderstanding of the nature of fully collateralized, rules-based, long-only commodity investment programs.

Definition of A Risk Management Position; Broadly Diversified

A "risk management position", as defined in proposed Rule 150.1(j), would mean a futures or futures-equivalent position, held as part of a broadly diversified portfolio of long-only or short-only futures or futures-equivalent positions, that is based upon (i) a fiduciary obligation to match or track the results of a "broadly diversified index" that includes the same commodity markets in fundamentally the same proportions as the futures or futures-equivalent position or (ii) a portfolio diversification plan that has, among other substantial asset classes, an exposure to a "broadly diversified index" that includes the same commodity markets in fundamentally the same proportions as the futures or futures-equivalent position. For this purpose, a "broadly diversified index", as defined in proposed Rule 150.1(k), would mean an index based on physical commodities in which (i) not more than 15% of the index could be composed of any single agricultural commodity named in Rule 150.2; and (ii) not more than 50% of the index as a whole could be composed of the agricultural commodities named in Rule 150.2.

Gresham objects to these numerical criteria which we find to be overly restrictive as well as unnecessary to address the Commission's concerns about market integrity. Together these numerical criteria would preclude the availability of a risk management exemption for long-only (or short-only) futures positions taken to replicate the returns of virtually any diversified index of agricultural commodities. For example, corn represents 17.2% of the TAP[sm] Agriculture Index; soybeans represent 33.9% of the TAP[sm] Agriculture Index; and wheat represents 23.5% of the TAP[sm] Agriculture Index. Similarly, corn represents 23.4% of the SPGSCI Agriculture Index and 15.6% of the DJAIG Agriculture Index; soybeans represent 16.6% of the SPGSCI Agriculture Index and 41.6% of the DJAIG Agriculture Index; and wheat represents 40.7% of the SPGSCI Agriculture Index and 19.9% of the DJAIG Agriculture Index. Thus, corn, soybeans and wheat represent 74.6% of the TAP[sm] Agriculture Index; 80.6% of the SPGSCI Agriculture Index; and 77.1% of the DJAIG Agriculture Index. In our view, the Commission should not apply these criteria to a diversified index which otherwise

1 As Acting Chairman Walter Lukken recently stated:

> "With such high energy prices, it is not surprising that some have found fault with the futures markets. But blaming the futures markets for high commodity prices is like blaming a thermometer for it being hot outside."

See Acting Chairman Walter Lukken, Remarks By Acting CFTC Chairman Walter Lukken on Compliance and Enforcement in Energy Markets – The CFTC Perspective at the FERC Compliance Summit (Jan. 18, 2008).

meets the proposed conditions for an exemption because a commodity investment program based upon replicating the returns of such an index could not readily operate as a mechanism for evading speculative position limits in any of those commodities. In particular, given that trading could not occur on the basis of speculative market views, price targets or price trends, that the positions must be unleveraged and that such an index must be calculated, adjusted and re-weighted pursuant to an objective, predetermined mathematical formula under the Proposal, it is not likely that such trading would be susceptible for being used for evading speculative position limits or any other similar purpose.

We also find it anomalous that a swap dealer may obtain a position limit exemption for long futures positions entered into to offset the exposure on commodity price swap transactions involving the same commodities underlying such an index, but an investment manager implementing a fully collateralized, rules-based, long-only commodity investment program involving such an index would not be eligible for a risk management exemption. See 72 Fed. Reg. 66097 at 66099 (discussing hedge exemptions granted to swap dealers). If adopted as proposed, an investment manager could enter into commodity price swap transactions with dealers to fulfill its fiduciary obligation to its clients to replicate the returns of such an index, but would be precluded from using the futures markets directly to satisfy its clients' risk management needs more cheaply, quickly, and efficiently.

Accordingly, we urge that the Commission delete the proposed numerical criteria in connection with adopting final rule amendments. If, however, the Commission determines to retain numerical criteria in the final rule amendments, we ask that such criteria be substantially modified to accommodate fully collateralized, rules-based, long-only commodity investment programs involving a diversified index of agricultural commodities such as those which we have noted in this letter.

On another point, we ask that the Commission confirm that certain language in the proposed definition of a "risk management position" (i.e., "the same commodity markets in fundamentally the same proportions") would not preclude an investment manager from making certain adjustments to the futures or futures-equivalent position to address circumstances in which applicable laws, investment guidelines, religious beliefs or local custom prohibit a client from investment exposure to a specific commodity in the index (such as lean hogs), with the result that the other commodities in the index are given additional weight on a pro rata basis, including commodities subject to federal speculative position limits such as corn, soybeans and wheat.

Conditions for Risk Management Positions

To be eligible for an exemption, risk management positions, as defined in proposed Rule 150.1(j), would be required to meet the conditions specified in proposed Rule 150.3(a)(2): (i) the positions must be passively managed; (ii) the positions must be unleveraged; and (iii) the positions must not be carried into the spot month. We have significant concerns about certain aspects of the first two proposed conditions, but we do not object to the third proposed condition.

Passively Managed

We note that CFTC Letter No. 06-19, supra, does not impose a condition that the positions subject to the no-action relief be passively managed, but rather states that the "futures trading activity passively tracks the [index-based] strategy." Indeed, that letter recognizes that the investment manager exercises some element of active management both with respect to the timing of the roll, as well as the subsequent contract month to which the positions will be rolled, in consideration of such factors as liquidity, prevailing prices and spreads, and other market conditions. Thus, to be consistent with the prior no-action relief, Gresham believes that an element of active management as to both the timing of the roll, as well as the contract month to which the positions will be rolled, should be permissible under the conditions for an exemption. In this regard, we ask that the Commission confirm that the "passively managed" condition, which allows some discretion with respect to trading decisions, would permit and not preclude rolling forward into more distant contract months, as well as nearby contract months, pursuant to an objective, pre-determined mathematical formula, so long as no positions are carried in the spot month.

Absence of Leverage

Under the Proposal the notional value of qualifying futures positions may not exceed the sum of the value of: (i) cash set aside in an identifiable manner, or unencumbered short-term U.S. Treasury obligations so set aside, plus any funds deposited as margin on such positions; and (ii) accrued profits on such positions held at the futures commission merchant. In addition to cash and short-term U.S. Treasury obligations, however, the prior no-action letters permit qualifying futures positions to be covered by cash equivalents such as cash deposited in a money market mutual fund. Gresham believes that the use of cash equivalents such as money market mutual funds is fully consistent with the unleveraged nature of these strategies and should therefore be permissible under the conditions for an exemption. We also note that Chicago Mercantile Exchange ("CME") Rule 559 and Chicago Board of Trade ("CBOT") Rule 559, both of which provide exemptions from position limits for risk management positions, permit qualifying futures positions to be covered by a variety of unencumbered short-term instruments such as U.S. agency discount notes, bankers' acceptances, and certificates of deposit, in addition to cash and short-term U.S. Treasury obligations. We perceive no underlying policy or purpose that would be served by imposing a more restrictive condition in the circumstances presented here, nor has the Commission articulated any such policy or purpose.

Duty to Report

Pursuant to proposed Rule 150.3(a)(2)(iv), a holder of a risk management exemption would be required to report immediately to the Commission in the event it knows, or has reason to know, that any person holds a greater than 25% interest in such position. This requirement is apparently designed to alert the Commission to the possibility that an individual might be attempting to use the exemption as a means of avoiding otherwise applicable speculative position limits. Gresham believes that this condition for receiving a risk management exemption is burdensome and unnecessary. As the commodity investment manager Gresham controls all futures and futures equivalent option positions entered into on behalf of its client accounts, whether funds or separate accounts, to implement its fully collateralized, rules-based, long-only commodity investment program, and no other person may exercise trading control over these positions. As noted, we believe that the inherent nature of these programs, in particular limited discretion with respect to trading decisions and the absence of leverage, precludes their effectiveness as a mechanism for avoiding otherwise applicable speculative position limits. Also, even though the Commission recognizes that a fund operator may not know when a given person has acquired a 25% or more interest in the position held by the fund, the Commission has not provided any practical guidance concerning how a fund operator should attempt to comply with this condition if the Commission determines to retain it in the final rule amendments.

Other Types of Index-Based Trading

Finally, Gresham believes that a risk management exemption should appropriately include additional types of rules-based commodity investment programs which are consistent with other categories of risk management or non-speculative positions recognized by the Commission and the exchanges in analogous contexts. See 52 Fed. Reg. 34633 (September 14, 1987). See also CME Rule 559 and CBOT Rule 559. For example, if to enhance its income the manager of a fully collateralized, rules-based, long-only commodity index fund writes call options on futures contracts equivalent in value to a portion of its portfolio of long futures contracts to be used as cover for such options, we believe that the positions should be eligible for a risk management exemption. Similarly, if a fund manager wishes to purchase put options to provide some downside protection for a long-only commodity index fund, the positions should be eligible for a risk management exemption. Or, a manager may wish to engage in both writing covered call options and purchasing put options for a fund which is designed to offer a more conservative, income-oriented variation of a fully collateralized, rules-based, long-only commodity investment program. We believe that these positions share many fundamental attributes of long-only index-based positions or of other categories of risk management positions which should qualify them for an exemption from speculative position limits. In particular, we note that these positions would be unleveraged, so that financial considerations should not cause rapid liquidation of positions, and no positions would be carried into the spot month. We recognize that these other types of index-based investment programs may entail a somewhat higher level of trading discretion than would be permissible under the proposed conditions for an exemption, but this feature has not prevented the Commission from concluding that similar categories of positions (e.g., covered option writing) are eligible for a risk management exemption in analogous contexts.

In any event, the Commission should confirm that the final rule amendments are not intended to be all-inclusive, and that other types of index-based positions, upon further analysis, may well be eligible for receiving a risk management exemption. The Commission also should confirm that exchanges may include similar risk management exemptions in their speculative position limit rules.

Conclusion

Gresham appreciates this opportunity to submit our comments on the Proposal and the Commission's consideration of our views. We would be pleased to discuss our comments further.

Sincerely,

Jonathan S. Spencer
President

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