COMMODITY MARKETS OVERSIGHT COALITION

An Alliance of Commodity Derivatives End-Users and Consumers

February 10, 2014

Via Electronic Submission

Attn: Melissa Jurgens, Secretary
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, N.W.
Washington, DC 20581

Re: Notice of Proposed Rulemaking, "Position Limits for Derivatives," RIN 3038-AD99, 78 *Fed. Reg.* 75680, *et seq.* (December 12, 2013).

Dear Ms. Jurgens:

The Commodity Markets Oversight Coalition ("CMOC") and its member organizations appreciate the opportunity to provide the Commodity Futures Trading Commission ("CFTC") with the below comments and recommendations concerning the Notice of Proposed Rulemaking for *Position Limits in Derivatives* ("Proposed Rule"). We commend the CFTC and its Commissioners and staffs for the careful consideration of input received from market participants and the general public. Please note that this letter does not preclude the submission of additional comments and recommendations by various CMOC-affiliated organizations or their constituent industries or member companies.

I. Background

The CMOC is a non-partisan alliance of industry groups and other organizations that represent commodity-dependent American businesses, end-users and consumers. Our members rely on functional, transparent and competitive commodity derivatives (i.e., futures, options and swaps) markets as a hedging and price discovery tool. As a coalition we favor policies that promote market stability and confidence, prevent fraud and manipulation, and preserve the interests of *bona fide* hedgers and American consumers.

The commodity derivatives markets including energy and agricultural futures, options and swaps were created as tools for risk mitigation and price discovery for bona fide commercial hedgers. While speculators are necessary for the proper function of these markets, we have long held (and scores of recent studies have concluded) that failure to properly monitor and limit speculative activity can exacerbate price volatility, unhinge markets from real world supply and demand fundamentals, and create the opportunity for market manipulation.

Since its inception in 2007, CMOC has argued that speculative position limits are a necessary and appropriate means to prevent market manipulation and curb excessive financial speculation. Therefore, we praised the inclusion by Congress of Section 737 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act")[1] requiring the CFTC to establish and impose position limits for the purpose of "diminishing, eliminating, or preventing" excessive speculation as an "undue and unnecessary burden on interstate commerce."[2]

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[1] Pub. Law 111-203, 124 Stat. 1376 (2010), §737
[2] 7 U.S.C. § 6a(a)(1)

The decision by Congress to mandate position limits in Dodd-Frank was not without precedent. Congress first established position limits authority in the Commodity Exchange Act of 1936 ("CEA").[3] It did so after many years of hearings, studies and investigations that culminated with a 1926 study by the Grain Futures Administration that found "wild and erratic price fluctuations" in wheat prices were "largely artificial and were cause primarily, either directly or indirectly, by heavy trading on the part of a limited number of professional speculators." This report was an acknowledgement that large speculative positions can cause significant market distortions and even disconnect commodities from their underlying fundamentals, whether or not there is intent to manipulate prices.[4]

The position limits regime enacted in 1936 and first implemented and enforced by the Commodity Exchange Commission and, later, its successor (the CFTC) resulted in nearly sixty years of market stability and confidence. However, this regime was compromised in the 1990s with the introduction of position accountability limits as a weaker substitute for position limits, the expansion of the bona fide hedge exemption to various financial institutions and ultimately, the enactment of the Commodity Futures Modernization Act of 2000 ("CFMA").[5] The CFMA, among other things, exempted energy futures and over-the-counter ("OTC") swaps from speculative position limits.

Like the 74th Congress before it, the 111th Congress held many hearings to receive expert testimony on allegations of unwarranted volatility and price spikes in energy and agricultural futures markets that began shortly after the enactment of the CFMA and that culminated in the commodity price bubbles of 2007-2008. The decision to expand upon on the 1936 position limits statute was also the result of multi-year bipartisan investigations launched by the Senate Permanent Subcommittee for Investigations ("PSI") dating back to 2001. Ultimately the PSI published three investigations on the role of excessive speculation in the crude oil, natural gas and wheat markets.[6]

During hearings related to these studies and dozens of other hearings before Congress and the CFTC between 2005 and 2010, policymakers received testimony from market participants, academics, representatives of various CMOC-affiliated organizations or their member companies and other experts. These witnesses confirmed that the erosion of the position limits regime was a leading cause in market instability and wild price swings seen in recent years and that it had led to diminished confidence in the commodity derivative markets as a hedging and price discovery tool.

Lawmakers, newly armed with years of exhaustive studies, investigations and expert testimony into the role of excessive speculation in the commodity markets, decided to mandate position limits for commodity derivatives including energy and agricultural futures and swaps. Given the urgency of the matter, Congress required that the CFTC implement Section 737 within

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[3] Pub. Law 74-675, 49 Stat. 1481 (1936), §5

[4] Berkovitz, Dan, *Position Limits and the Hedge Exemption; Brief Legislative History,"* Testimony of the General Counsel, Commodity Future Trading Commission Hearing on Position Limits, Washington, DC (July 28, 2009).

[5] Pub. Law 106-554, Appendix E, 114 Stat. 2763 (2000)

[6] The Senate Permanent Subcommittee for Investigations published Staff Reports entitled *Excessive Speculation in Rising Oil and Gas Prices: A Need to put the Cop Back on the Beat* on June 27, 2006, *Excessive Speculation in the Natural Gas Market* on June 25, 2007, and *Excessive Speculation in the Wheat Market* on July 21, 2009.

180 days of the enactment of the Dodd-Frank Act.[7] A total of 1,128 days have passed since this initial deadline. We understand that litigation has been a major reason for the delay and for the introduction of this newly proposed rule. We nonetheless urge the CFTC to work quickly to finalize, implement and enforce a robust position limits rule and ensure stability and confidence to the commodity markets for generations to come.

III. Proposed Rule

As the CFTC works to finalize a position limits rule, we ask that consideration be given to the following comments and recommendations.

a. Spot Month Position Limits should be Lower and Subject to Annual Review

Consistent with its original October 18, 2011 position limits rule, the CFTC has proposed setting the initial Spot Month Limit at no greater than 25 percent of estimated deliverable supply for 28 Core Referenced Commodity Futures Contracts as provided by the relevant Designated Contract Market ("DCM") or as otherwise determined by the CFTC.[8] We continue to believe that this level is too high to capture all potentially harmful trading activity. As noted by the CFTC, DCMs have commonly found spot month limits at levels below 25 percent to be desirable and that each commodity's unique production, supply and delivery features should be considered. We further agree with the CFTC that setting the spot month limit at a lower level than 25 percent "may also serve the objectives of preventing excessive speculation, manipulation, squeezes and corners, while ensuring sufficient market liquidity for bona fide hedgers in the view of the listing DCM and ensuring the price discovery function of the market is not disrupted."[9]

Therefore, while we are pleased that this is only an "initial" level and that the CFTC is committed to regular review of Spot Month Position Limits, we are disappointed that the CFTC has proposed to update and review the spot month limit only on a biennial basis (i.e., every two years).[10] The CFTC has stated that "biennial updates would reduce the burden on market participants in updating speculative position monitoring systems." In an era of lightning-fast and almost artificially intelligent automated trading software, we fail to understand how changing a series of numbers in position monitoring software more than every two years can be considered a "burden."

The CFTC, in consultation with commodity hedgers and end-users as represented by the Agriculture and Energy Advisory Committees, should (1) meet within one year of the implementation of the proposed rule to discuss whether a lower limit is necessary to ensure market stability and prevent excessive speculation and market manipulation; and (2) we believe the CFTC should conduct such meetings on an annual basis thereafter.

b. We Oppose the Creation of a Conditional Spot Month Limit Exemption

The CFTC has proposed the creation of a "conditional spot month limit" that would allow a trader to hold up to five times the spot month limit if such positions are held exclusively in

[7] The Dodd-Frank Act required the CFTC to impose position limits under Section 737 within 180 days for energy and metals and 270 days for agricultural commodities.
[8] 78 *Fed. Reg.* 75728
[9] *Ibid.*, 75729
[10] Note that the proposed rule differs from the October 18, 2011 final rule which would have required biennial review of spot month position limits for energy every two years and agricultural commodities on an annual basis.

cash-settled contracts and if the trader does not hold or control positions in a spot-month physical-delivery referenced contract.[11] Given that the initial spot month position limit would be set at 25 percent of deliverable supply as mentioned above, the conditional spot month limit would initially be set at 125 percent of deliverable supply.

A similar proposal was previously considered by the CFTC when promulgating the now vacated rule, except that proposal would have required a trader to hold physical commodity inventory of 25 percent of deliverable supply or less in order to qualify for the exemption. In lieu of this requirement, the CFTC will require "enhanced reporting of cash market holdings" by traders who are claiming the conditional spot month limit exemption. The CFTC believes this increased transparency and surveillance to be sufficient in deterring excessive position taking and possible manipulation of the cash market.[12] Further, under the vacated rule, the conditional spot month limit exemption would have only applied to natural gas referenced contracts. The CFTC is considering the expansion of the conditional spot month limits to all core referenced contracts.[13]

As we did when the CFTC first proposed the creation of a conditional spot month limit exemption as part of the position limits rule in 2011, the CMOC opposes the creation of a conditional spot month limit in the newly proposed rule.[14] Cash-settled and physically-settled contracts are economically equivalent. Even with the proposal to expand reporting and surveillance requirements for traders utilizing the conditional spot month limit exemption, we are concerned that this proposal could jeopardize the price discovery function, diminish the integrity of the physically-delivered contract, disrupt the efficacy of markets in the closing period and open the door to possible market manipulation. Further, the markedly decreased liquidity in the physically-settled contract that could result from the conditional limit proposal may substantially increase costs on bona fide hedgers. We are also concerned that conditional limits could be utilized by passive investors (i.e., commodity index funds) to evade more stringent trading requirements in the physically-settled contract market.

c. Commodity Index Activity Should Not Be Considered a Bona Fide Hedge

The harm caused by commodity index funds has been well-documented. The June 2009 report of the Senate Permanent Subcommittee for Investigations (PSI) on the role of excessive speculation in the wheat market is just one example.[15] This bipartisan report concluded that the "activities of commodity index traders, in the aggregate, constituted 'excessive speculation,'" and that index funds have caused "unwarranted price changes" and constitute an "unwarranted burden on commerce." The PSI report urged the CFTC to take appropriate measures to limit the impact of index fund investments in commodities.

After years of urging the CFTC to limit the role of commodity index funds, we are pleased that the Commission is proposing to exclude swaps that reference indices such as the Goldman Sachs Commodity Index (GSCI) from the definition of a Referenced Contract.[16] Commodity index funds are investment vehicles utilized by pension funds, endowments and others to speculate in crude oil,

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[11] 78 *Fed.Reg.* 75736
[12] *Ibid.,* 75737
[13] *Ibid.,* 75738
[14] See the Commodity Markets Oversight Coalition Letter to the Commodity Futures Trading Commission on Conditional Spot Month Limits, August 31, 2011.
[15] Link to the Senate PSI Wheat Report: http://bit.ly/WheatRpt (Accessed May 1, 2013)
[16] Proposed Rule 150.1

wheat and other commodities. Unlike traditional speculators, these often "passive investors" have little or no regard for real world economic indicators. They are not bona fide hedgers, since they are not hedging any real or anticipated commercial risk associated with the price of a physical commodity. Therefore, we further advise the CFTC to reject calls to create an explicit enumerated hedge exemption or any other type of regulatory exemption for the benefit of commodity index funds.

IV. Conclusion

Again, we would like to thank Acting Chairman Mark Wetjen, Commissioners Bart Chilton and Scott O'Malia and all of the staff at the CFTC for their hard work and due diligence in promulgating this proposed rule. We further appreciate the opportunity to have our coalition's input considered as you work in the coming weeks to write a final rule. If you would like additional information or to discuss these issues further, please feel free to contact us.

Sincerely,

Jim Collura, Vice President for Government Affairs
New England Fuel Institute
Co-chair, Commodity Markets Oversight Coalition

Sherri Stone, Vice President
Petroleum Marketers Association of America
Co-chair, Commodity Markets Oversight Coalition

Organizations Endorsing this Comment Letter:

Airlines for America
American Bakers Association
American Trucking Associations
American Feed Industry Association
California Black Agriculture Working Group
Colorado Petroleum Marketers Association
Connecticut Energy Marketers Association
Florida Petroleum Marketers Association
Fuel Merchants Association of New Jersey
Gasoline & Automotive Service Dealers of America
Industrial Energy Consumers of America
Institute for Agriculture and Trade Policy
Louisiana Oil Marketers & Convenience Store Association
Maine Energy Marketers Association
Massachusetts Energy Marketers Association
Montana Petroleum Marketers & Convenience Store Association
Continued…

National Association of Oil & Energy Service Professionals
National Grange
National Family Farm Coalition
National Latino Farmers & Ranchers Trade Association
National Association of Shell Marketers
New England Fuel Institute
New Mexico Petroleum Marketers Association
New York Oil Heating Association
Oil Heat Council of New Hampshire
Oil Heat Institute of Long Island
Oil Heat Institute of Rhode Island
Organization for Competitive Markets
Petroleum Marketers & Convenience Store Association Kansas
Petroleum Marketers & Convenience Stores of Iowa
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