From: David Pais <davidpais@gmail.com>
Sent: Tuesday, April 20, 2010 7:44 AM
To: secretary <secretary@CFTC.gov>
Cc: Sherrod, Stephen <SSherrod@CFTC.gov>
Subject: Comment on Federal Speculative Position Limits for Referenced Energy Contracts, Federal Register Release 75 FR 4143

To,
The Secretary,
Commodity Futures Trading Commission,
Three Lafayette Centre,
Washington, DC 20581.

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Dear Mr. Stawick,

I am an economist who has worked for Morgan Stanley and Citigroup and would like to use the CFTC's requests for comments on proposed energy position limits to make a proposal which is similar in spirit to the CFTC's, which achieves all the CFTC's objectives but which, crucially, also bypasses the debate over whether financial players are distorting energy prices.

I have outlined this proposal in greater detail below. It allows for 'speculative' positions for market making purposes while ensuring that it is only 'commercial' participants who ultimately determine energy prices. I do hope you will take the time to go through it, as I believe it is more elegant than the one currently proposed by the CFTC and more likely to achieve its objectives. If you require any further clarification, I can be contacted at this email address.

Regards,

David Pais

Firedoors for Commodity Markets

The central issue which the CFTC's proposed rule on "Federal Speculative Position Limits for Referenced Energy Contracts" seeks to address is the role of financial institutions in commodity markets. Large financial institutions like Morgan Stanley and Goldman Sachs claim that they are only providing much needed liquidity services to commodity markets and that their proprietary trading interests are negligible. Notwithstanding President Obama's proposed 'Volcker Rule', it will be virtually impossible to distinguish a trading desk's liquidity provision services ('bona fide risk management positions') from its prop trading ('speculative positions'). This raises the possibility that excess liquidity resulting from large increases in leverage at banks could flow into the commodity markets. Whether or not large financial institutions have been distorting commodity prices (and my own personal view is that they have) could actually be made irrelevant for the CFTC's purposes going forward.

The solution lies in limiting access to commodity markets to two kinds of participants – 'commercials' (airlines, refiners etc.) and a new category of Specialist Commodity Brokers (SCBs). These SCBs would be allowed to provide all the 'liquidity' and 'market making' services currently provided by investment banks like Morgan Stanley and Goldman Sachs, but would be precluded from offering any other financial services outside of the commodity markets. Additionally, the SCBs could be regulated such that they only engage in broking (matching buy and sell orders over a few days or so) and not dealing (taking longer term risk on to their books).

The SCBs would also be limited to taking orders only from certified 'commercial' interests (airlines, refiners etc) and not from financial players with 'non-commercial' interests (investment banks, hedge funds, ETFs etc.). The intellectual basis for this restriction lies in the fact that commodities do not pay dividends like stocks, nor do they pay interest like bonds. They can only be consumed. They should therefore not be considered an 'asset class'.

The CFTC could auction a fixed number of licenses for SCBs on a 3 or 5 year basis depending on the CFTC's assessment of the competitive conditions for SCBs. Since SCBs must be standalone entities, they would not be allowed to be a part of the operations of any bank, hedge fund, insurance company etc. They would have to raise the funds for their market making activities independently but would also be insulated from large increases in leverage which typically occur during financial booms. By all accounts, market making in commodities is a steady and profitable business and it should be fairly straightforward for the SCBs to raise the requisite funds at relatively cheap rates.

Stable commodity markets which reflect the fundamentals of the real economy are a global public good. This proposal of a firedoor for commodity markets would ensure that the legitimate task of market making could still be provided by SCBs on Wall St. but would be insulated from the excesses of the rest of the financial system. It has the added benefit that it would obviate the need for the CFTC to have to try and distinguish 'bona fide risk management positions' from 'speculative positions'.

This solution achieves all the CFTC's objectives without burdening it with having to micro-investigate and monitor the trading books of investment banks and the trading activities of the rest of the financial community. It allows for the participation of financial players in market making activities in the commodity markets. Most importantly, commercial participants (airlines, refiners etc.) would receive the liquidity services they need without the undue influence of 'non-commercial' participants. Accordingly, commodity prices would be determined solely by demand and supply in the real economy. To borrow President Obama's analogy, this solution of instituting firedoors via the SCBs uses a scalpel rather than an axe to ensure that financial markets are functioning and serving the needs of ordinary Americans.