

**From:** Simone Allen <SAllen@partnershipfc.com>  
**Sent:** Monday, April 26, 2010 10:00 AM  
**To:** secretary <secretary@CFTC.gov>  
**Cc:** Mike Masters <mmasters@masterscapital.com>; Simone Allen <SAllen@partnershipfc.com>; Adam White <adam.white@whtknt.com>  
**Subject:** CFTC Comments from Michael W. Masters  
**Attach:** CFTC Position Limits Comments.pdf

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Dear Mr. Stawick,

Attached please find a letter and comments from Michael W. Masters.

Thank you,

Simone Allen  
Partnership Financial Consulting, LLC  
[sallen@partnershipfc.com](mailto:sallen@partnershipfc.com)  
Direct: 404-504-8840  
Main: 404-364-2019  
Fax: 404-364-2013

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April 23, 2010

VIA ELECTRONIC MAIL

David Stawick  
Secretary of the Commission  
Commodities Futures Trading Commission  
Three Lafayette Center  
1155 21st Street, NW  
Washington, DC 20581  
secretary@cftc.gov

Dear Mr. Stawick:

Attached are my comments on the "Federal Speculative Position Limits for Referenced Energy Contracts and Associated Regulations" (Federal Register / Vol. 75, No. 16 / Tuesday, January 26, 2010 / Proposed Rules / pages 4144-4172).

Thank you very much for accepting and considering my comments.

Sincerely,

Michael W. Masters  
Portfolio Manager / Managing Member  
Masters Capital Management, LLC  
P.O. Box 224229  
Christiansted, VI 00822  
(340) 692-5102

## **GENERAL COMMENTS:**

I applaud the Commission for taking this strong first step to protect the energy derivatives markets against manipulation. Therefore I wholeheartedly endorse the proposed rule.

I would however be remiss if I did not point out that two additional steps must be taken to fulfill the Commission's responsibility to protect these markets against fraud, manipulation and excessive speculation.

The second step needed (after the first step contained in this proposed rule) would be to establish a speculative percentage target for the energy markets and then to reduce individual speculative position limits in the energy markets until the overall level of speculation falls within the targeted range. This would eliminate the currently excessive amount of speculation that is demoralizing these markets, damaging the price discovery function and making it difficult for bona fide physical producers and consumers to hedge their commodity price risk.

The third step needed is to address the severe problem of passive speculation. This can be accomplished by a ban or severe restriction on the practice of passive speculation. An example of a severe restriction would be setting passive speculative position limits at 10% of the level reserved for active speculators. Passive speculators have made these markets excessively speculative and they hold massive concentrated positions allowing them to wield undue market power.

Without these two additional steps, the first step of setting speculative position limits might actually end up doing more harm than good. By adopting a formula that mitigates the threat of manipulation but does not diminish, eliminate or prevent excessive speculation, this codifies the formula (setting it as a precedent) while effectively sidelining the issue of excessive speculation. At a minimum it confuses the concepts of manipulation and excessive speculation. And at worst this formula could actually lead to greater amounts of speculation in the future as I explain below.

There are six general points I want to make before I directly address the questions you pose in the Notice of Proposed Rulemaking.

### **General Comment 1: Position Limits Can Serve Two Potential Roles: Manipulation Mitigation and Excessive Speculation Prevention.**

Regulators may impose position limits for two possible reasons:

First, they can be imposed to reduce the potential threat of market manipulation. Manipulation occurs when a small group of traders wield large positions in order to unduly influence the market price. By limiting the size of the positions that traders can hold, position limits make it harder for these traders to manipulate the markets.

The second reason regulators might impose position limits is to diminish, eliminate or prevent excessive speculation. Excessive speculation is a condition of the marketplace as a whole where the positions held by speculators (none of whom individually has manipulative intent) constitute such a high percentage of the total open interest that speculators comprise the driving force behind the price discovery function.

By imposing speculative position limits, regulators can reduce the size of speculators' positions, and therefore reduce their dominance over the price discovery function. The goal is not the restraint of any one trader, but rather an overall reduction in speculation to remove the potential for consumable commodities derivatives markets to experience speculative price bubbles.

This proposed rule fails to draw a distinction between manipulation and excessive speculation and in fact it confuses the two in several instances.

### **General Comment 2: There Are Two Distinct Methodologies For Setting Position Limits.**

Position limits may be set using one of two different methodologies, depending on the regulatory goal:

If the goal is to mitigate the threat of manipulation, regulators should set the level of individual position limits at a specified percentage of total open interest. This will ensure a minimum number of market participants, while limiting the ability of any single participant to manipulate prices. As an example, by setting speculative position limits at 2.5% of total open interest, regulators are ensured to have at least 40 market participants, and further assured that no individual speculator will account for more than 1/40th of the market.

In contrast, if the goal is to prevent excessive speculation, regulators should establish an acceptable level of speculation in the marketplace as a whole, expressed as a percentage of open interest. As a general rule of thumb, speculators should never represent more than 50% of open interest, because at that level, they will dominate the price discovery function, due to the aggressiveness and frequency of their trading. The level I recommend is 25%; this will provide sufficient liquidity, while ensuring that physical producers and consumers dominate the price discovery function. Optimal speculative levels will vary between commodities due to differences in market structure but 25% is a good starting point for those market-specific discussions.

Once the target level of speculation is determined, regulators should reduce individual position limits, in order to reduce the overall speculative percentage, until it falls within the acceptable range. As an example, assume that the acceptable

range of speculative interest has been identified as 20-30%. If 600,000 contracts are held by speculators and the open interest is 1,000,000 contracts, then the speculative percentage is 60%, which is far in excess of the acceptable range. In this example, individual limits must be reduced in order to reduce the aggregate speculative percentage to the acceptable level.

Consumable commodities derivatives markets are unique because they are susceptible to both manipulation and excessive speculation. Regulators should calculate position limits utilizing both methodologies and set the limit at the tighter of the two.

Please note that if regulators set position limits solely using the manipulation mitigation formula – limiting the positions of individual traders, versus limiting aggregate speculation in the overall market – the unintended result will be an increase in excessive speculation. If individual limits were based solely on a simple percentage of open interest without regard for the overall speculative composition of that open interest, regulators would actually be inviting more speculation and increase the risk for excessive speculation.

This can be illustrated with an example. Assume a market with open interest of 1,000,000 contracts. Bona fide physical hedgers hold 700,000 contracts, and the remaining 300,000 are held by 60 speculators, who each hold an average of 5,000 contracts. In this market, individual speculative position limits have been set at 1% of open interest, or 10,000 contracts per speculator. If each of those 60 speculators takes their position up to the limit of 10,000 contracts, then open interest becomes 1,300,000 contracts (representing a rise in speculative percentage from 30% to 46%). Now, the 1%-of-open-interest position limit automatically adjusts upward from 10,000 contracts to 13,000 contracts, enabling speculators to increase their positions again to as much as 780,000 contracts (representing a rise in speculative percentage to 53%). Left unchecked, this chain reaction could lead to higher and higher levels of speculation.

**General Comment 3: Consumable Commodities Derivatives Markets Dominated by Physical Producers and Consumers Do Not Experience Speculative Price Bubbles, While Markets Dominated by Speculators Often Do.**

In the capital markets (stocks, bonds, etc.) and in the corresponding financial futures markets, all of the market participants are speculators (or investors, if you prefer). These markets can never be “excessively speculative” since they are 100% speculative by definition. Speculators assume risk by buying stocks and bonds, and they reduce risk by selling those same stocks and bonds. They can also use derivatives to add to or subtract from their market risk. All capital markets are subject to speculative euphoria, which can create speculative price bubbles. We have seen bubbles in all the major capital markets in the last 15 years.

Under normal conditions, physical commodity markets, like the markets for all goods and services (other than capital goods), do not experience price bubbles. In Economics 101 we learned that when demand exceeds supply, prices will rise encouraging consumers to consume less (reducing demand) and producers to produce more (increasing supply), and prices will then fall back to their long-term equilibrium (the marginal cost of production). This relationship between supply, demand, and price is the natural mechanism that prevents price bubbles in commodity goods markets.

The derivatives markets for consumable commodities are unique hybrid markets where physical commodity producers and consumers come to hedge, while speculators come to make trading profits. When physical producers and consumers dominate, their derivatives trading will reflect the real-world supply and demand conditions they are experiencing in the physical commodity markets. In contrast, when speculators dominate, the consumable commodities derivatives markets become “financialized” and susceptible to speculative price bubbles like those seen in the capital markets.

**General Comment 4: The Derivatives Markets for Most Consumable Commodities Are Currently Dominated by Speculators and Suffering from Excessive Speculation and Price Bubbles.**

In 1998, the average commodity derivatives market was about 25% speculative as a percentage of open interest. By 2008, speculators comprised about 65% of open interest. Bona fide physical hedgers once outnumbered speculators 3 to 1; now speculators outnumber hedgers 2 to 1. The positions of bona fide physical hedgers doubled during this ten-year period, while the positions of speculators rose by 1200%.<sup>1</sup>

Today we need speculative position limits, imposed by the CFTC, in all consumable commodities derivatives markets that will force speculators to exit these markets, thereby reducing speculators’ dominance and eliminating the possibility of speculative price bubbles.

No one complained about a lack of liquidity in 1998 when the markets were 25% speculative. That is ample liquidity to serve the hedging needs of bona fide physical producers and consumers.

In capital markets, speculative price bubbles make investors feel good as they expand, and when they pop, the damage is limited to the capital lost by investors. In sharp contrast, speculative price bubbles in consumable commodities inflict intense pain on our economy as they expand. These bubbles can be prevented by

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<sup>1</sup> See Appendix 3 of my recent CFTC Testimony on Position Limits in Metals Markets on March 25, 2010

speculative position limits. Every man, woman and child in America suffered unnecessarily due to the 2008 bubble in oil prices.

**General Comment 5: The Core of Our Current Excessive Speculation Problem Is a Passive Speculation Problem.**

Like one of those Russian dolls, we have a problem within a problem. The main reason that speculation in consumable commodities has grown so dramatically in the last 10 years is the rise in passive speculation by those seeking to “invest” in multiple-commodity and single-commodity derivatives structures. Today, passive speculators outnumber active speculators and account for the lion’s share of speculative open interest in many consumable commodities.<sup>2</sup>

Active and passive speculators are two very different animals, and to understand the distinctions between the two is to appreciate the extent of the threat posed by passive speculators. Active speculators add beneficial liquidity to the market by buying and selling futures contracts with the goal of turning a quick profit. In contrast, passive speculators drain liquidity by buying and holding large quantities of futures contracts – basically acting as consumers who never actually take delivery of goods. Passive speculators “invest” in a commodity or basket of commodities (such as an index), and continuously roll their position, as part of a long-term portfolio diversification strategy. This strategy is completely blind to the supply and demand realities in the market. As such, passive speculators not only undermine, but actually destroy the price discovery function of the market and make way for the formation of speculative bubbles.

Passive speculators are an invasive species that will continue to damage the markets until they are eradicated. The CFTC must address the issue of passive speculation; it will not go away on its own. When passive speculators are eliminated from the markets, then most consumable commodities derivatives markets will no longer be excessively speculative, and their intended functions will be restored.

**General Comment 6: Passive speculators also represent a clear and present threat of manipulation due to their excessively concentrated positions and the market power that swaps dealers enjoy managing these strategies.**

The Commodity Exchange Act states that “such limits upon positions and trading shall apply to positions held by, and trading done by, two or more persons acting pursuant to an **expressed** or implied **agreement** or understanding, the same as if the positions were held by, or the trading were done by, a single person.”<sup>3</sup> In the case

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<sup>2</sup> See Appendix 3 of my recent CFTC Testimony on Position Limits in Metals Markets on March 25, 2010

<sup>3</sup> 7 USC 1.6a(a), emphasis mine

of passive index speculators they are all marching to the exact same tune as spelled out in the written documentation of that particular index's methodology.

So as an example, investors speculating in the Goldman Sachs Commodity Index (GSCI) are required to purchase the exact same 24 commodity futures on the exact same days in the exact same proportions and to roll those futures forward in the exact same manner in order to replicate the GSCI. The agreement they are following is so explicit that it is written down for the world to see. The same can be said of the passive single-commodity speculators represented by Exchange Traded Funds (ETFs) such as the USO, UNG and others who also have written down trading methodologies that they and everyone else following them must adhere to.

Because they are all acting in "express agreement" they should all be subject to the speculative position limit of a single person. Collectively these passive speculators constitute a single uber-speculator that dwarfs all other market participants and wield huge market power because of their massive positions.

The CFTC has received repeated testimony for several years now decrying how clearly disruptive the actions of passive speculators are to the consumable commodities derivatives markets. The CFTC would never permit a single speculator to wreak this much havoc in the marketplace and yet it allows passive index speculators to do so even though the Commodity Exchange Act clearly states that passive index speculators should have the position limits of a single speculator.

It is also imperative to point out that the Swaps Dealers that are managing these index positions for their institutional investor clients are the beneficiaries of the enormous market power inherent in these massive positions. Because they have discretion to adjust their "hedges" at different times and in differing ways, they can wield this power for their own benefit in the marketplace.

#### **SPECIFIC RESPONSES TO REQUESTS FOR COMMENT**

*1. Are Federal speculative position limits for energy contracts traded on reporting markets necessary to "diminish, eliminate, or prevent" the burdens on interstate commerce that may result from position concentrations in such contracts?*

Federal speculative position limits are necessary for all energy derivatives traded on all markets (including over-the-counter markets) for two purposes (1) to mitigate the threat of manipulation and (2) to diminish, eliminate or prevent excessive speculation. The Commodity Exchange Act (CEA) makes it clear that the Commodity Futures Trading Commission (CFTC) must take steps to protect the markets and the price discovery function from both manipulation and excessive speculation.



*2. Are there methods other than Federal speculative position limits that should be utilized to diminish, eliminate, or prevent such burdens?*

In the case of mitigating manipulation there are additional methods that could be employed such as “accountability” limits and monitoring of positions and trading by the exchanges. In the case of diminishing, eliminating or preventing excessive speculation, margin requirements could be raised for speculators, but I believe that is less effective than appropriately set position limits.

*3. How should the Commission evaluate the potential effect of Federal speculative position limits on the liquidity, market efficiency and price discovery capabilities of referenced energy contracts in determining whether to establish position limits for such contracts?*

The Commission needs to recognize that bona fide physical producers and consumers engaged in hedging are the primary constituency in the consumable commodities derivatives markets and the ones that strengthen and protect the price discovery function. Speculators play an important supporting role by providing liquidity to bona fide physical hedgers.

So speculators should be permitted in the markets to the extent that they provide necessary liquidity. But these markets do not require unlimited or excessive liquidity and Congress inherently recognized this fact by charging the CFTC with diminishing, eliminating and preventing excessive speculation.

There is a law of diminishing returns for marginal increases in speculative liquidity. Once there is sufficient speculative liquidity to even out the buying and selling of bona fide physical hedgers then the markets do not benefit from marginal increases in speculative liquidity. It is like the air pressure in a tire. If your tire calls for 35 pounds of air pressure and you try to run it on 15 pounds of air pressure then it will be a bumpy ride. If you try to run it on 150 pounds of air pressure then it will blow up the tire.

Historically the consumable commodities derivatives markets have had sufficient liquidity when roughly 25% of open interest was held by speculators. The Commission should begin slowly bringing down speculative position limits in the energy derivatives markets and observe the effects on liquidity. If bona fide physical hedgers begin complaining about a lack of liquidity then position limits should be raised up again. Right now bona fide physical producers and consumers are complaining loudly about excessive speculation and not at all about a lack of liquidity. This is a strong indication that the markets are excessively speculative and that position limits need to be adjusted downward dramatically.

Please note that passive speculators consume liquidity and pose a serious threat to these markets. They should not be tolerated and every effort should be made to

force their exit from these markets. If a “one size fits all” position limit approach is adopted and much tighter limits are not adopted for passive speculators then lowering position limits might drive away more active speculators than passive speculators and lead to serious problems for market structure.

*4. Under the class approach to grouping contracts as discussed herein, how should contracts that do not cash settle to the price of a single contract, but settle to the average price of a subgroup of contracts within a class be treated during the spot month for the purposes of enforcing the proposed speculative position limits?*

I do not have a specific recommendation for this question.

*5. Under proposed regulation 151.2(b)(1)(i), the Commission would establish an all-months-combined aggregate position limit equal to 10% of the average combined futures and option contract open interest aggregated across all reporting markets for the most recent calendar year up to 25,000 contracts, with a marginal increase of 2.5% of open interest thereafter. As an alternative to this approach to an all months-combined aggregate position limit, the Commission requests comment on whether an additional increment with a marginal increase larger than 2.5% would be adequate to prevent excessive speculation in the referenced energy contracts. An additional increment would permit traders to hold larger positions relative to total open positions in the referenced energy contracts, in comparison to the proposed formula. For example, the Commission could fix the all-months combined aggregate position limit at 10% of the prior year's average open interest up to 25,000 contracts, with a marginal increase of 5% up to 300,000 contracts and a marginal increase of 2.5% thereafter. Assuming the prior year's average open interest equaled 300,000 contracts, an all-months combined aggregate position limit would be fixed at 9,400 contracts under the proposed rule and 16,300 contracts under the alternative.*

No formula based on open interest that does not account for the mix between speculative versus non-speculative positions will be the slightest bit effective at preventing excessive speculation. Therefore all of the above mentioned formulas will fail miserably in preventing excessive speculation. This can be seen quite clearly by the fact that in an energy market that is obviously excessively speculative the CFTC estimates that these limits will only affect “approximately ten” traders. Causing these ten traders to exit the markets will not result in a material reduction in speculation and therefore the markets will remain excessively speculative.

The formulas that are being discussed above are wonderful for the purposes of mitigating the threat of manipulation. And I support their implementation at the Federal level. It is however absolutely essential that the Commission does not confuse manipulation with excessive speculation and does not attempt to treat excessive speculation with a remedy that is only effective at mitigating manipulation.

6. *Should customary position sizes held by speculative traders be a factor in moderating the limit levels proposed by the Commission? In this connection, the Commission notes that current regulation 150.5(c) states contract markets may adjust their speculative limit levels “based on position sizes customarily held by speculative traders on the contract market, which shall not be extraordinarily large relative to total open positions in the contract \* \* \**

The formula proposed by the Commission will work well to mitigate the threat of manipulation. Position limits could be and should be tighter if the customary position sizes of speculative traders warrant tighter limits.

When seeking to set speculative position limits for the purpose of diminishing, eliminating or preventing excessive speculation the distribution of speculative traders’ customary position sizes should be taken into account. As mentioned previously this rule does little to reduce excessive speculation in the energy derivatives markets because it does not include the percentage of open interest held by speculators in its methodology for setting position limits.

<b>Number of Traders</b>	<b>Range of Contracts Held</b>	<b>Average Position Size</b>	<b>Total Contracts In Range</b>
300	< 1,000	500	150,000
50	1,001-5,000 contracts	3,000	150,000
20	5,001-10,000 contracts	7,500	150,000
5	> 10,000 contracts	30,000	150,000
<b>375 Total</b>		<b>1,600 Average</b>	<b>600,000 Total</b>

If for instance there were a hypothetical energy derivatives market where there were 1,000,000 contracts of open interest with 600,000 contracts held by speculators. A speculative percentage of 60% is unnecessarily high and needs to be reduced. If there were 300 speculators with positions less than 1,000 contracts, 50 speculators with positions between 1,001 and 5,000 contracts, 20 speculators with positions between 5,001 and 10,000 contracts and 5 speculators with contracts greater than 10,000 contracts, then a reduction of speculative position limits to 5,000 contracts would be appropriate to reduce the speculative percentage by half to 30% (300,000 contracts).<sup>4</sup> This could be accomplished gradually by first reducing the speculative position limit to 10,000 contracts and later reducing it further to 5,000 contracts. Please note that applying the position limits formula proposed by the Commission the speculative position limit would be 26,875

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<sup>4</sup> A 300,000 contract reduction in speculators’ positions most likely would result in a reduction of open interest by 300,000 contracts to 700,000. This would mean that speculation would remain somewhat elevated because the 300,000 remaining speculative contracts would represent 43% of the total open interest of 700,000 contracts. If there has been no impairment to liquidity then speculative position limits should be reduced further to 4,000 contracts or lower.

contracts, which would only affect a few speculators and leave this market excessively speculative.<sup>5</sup>

*7. Reporting markets that list referenced energy contracts, as defined by the proposed regulations, would continue to be responsible for maintaining their own position limits (so long as they are not higher than the limits fixed by the Commission) or position accountability rules. The Commission seeks comment on whether it should issue acceptable practices that adopt formal guidelines and procedures for implementing position accountability rules.*

I believe that accountability limits are inherently an exchange-directed phenomenon since exceeding the accountability levels triggers an action by the exchange. The CFTC should set “hard limits” and allow the exchanges to set “soft limits” that are more strict. Because they are “soft limits,” position accountability levels can be useful for mitigating manipulation but can never be used for combating excessive speculation. Exchanges set these limits for mitigating the threat of manipulation and exchanges share the desire of the CFTC to make their markets manipulation-free (or nearly so). On the other hand, exchanges have never wanted to reduce speculation where there was no evidence of manipulation since that would reduce the exchange’s profits. Only the CFTC can set speculative position limits for the purpose of diminishing, eliminating or preventing excessive speculation.

*8. Proposed regulation 151.3(a)(2) would establish a swap dealer risk management exemption whereby swap dealers would be granted a position limit exemption for positions that are held to offset risks associated with customer initiated swap agreements that are linked to a referenced energy contract but that do not qualify as bona fide hedge positions. The swap dealer risk management exemption would be capped at twice the size of any otherwise applicable all-months combined or single non-spot-month position limit. The Commission seeks comment on any alternatives to this proposed approach. The Commission seeks particular comment on the feasibility of a “look-through” exemption for swap dealers such that dealers would receive exemptions for positions offsetting risks resulting from swap agreements opposite counterparties who would have been entitled to a hedge exemption if they had hedged their exposure directly in the futures markets. How viable is such an approach given the Commission’s lack of regulatory authority over the OTC swap markets?*

I submitted detailed comments on the feasibility of a look through exemption when the Commission requested such comments back in March of 2009.<sup>6</sup>

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<sup>5</sup> 10% of the first 25,000 contracts is 2,500 contracts plus 2.5% of the remaining 975,000 contracts is 24,375 for a total position limit of 26,875 contracts.

<sup>6</sup> “Concept Release on Whether To Eliminate the Bona Fide Hedge Exemption for Certain Swaps Dealers and Create a New Limited Risk Management Exemption From Speculative Position Limits” (Federal Register / Vol. 74, No. 55 / Tuesday, March 24, 2009 / Proposed Rules / pages 12282-12286).

*9. Proposed regulation 20.02 would require swap dealers to file with the Commission certain information in connection with their risk management exemptions to ensure that the Commission can adequately assess their need for an exemption. The Commission invites comment on whether these requirements are sufficient. In the alternative, should the Commission limit these filing requirements, and instead rely upon its regulation 18.05 special call authority to assess the merit of swap dealer risk management exemption requests?*

The Commission should not rely upon its special call authority. It should make the risk management exemption from position limits conditional upon the receipt of the necessary information. That way if the swaps dealer is found to have provided inaccurate or misleading data to the Commission then the Commission can revoke the swap dealer's exemption from position limits. Right now, the penalty for providing inaccurate or misleading data in response to a special call is not a factor.

*10. The Commission's proposed part 151 regulations for referenced energy contracts would set forth a comprehensive regime of position limit, exemption and aggregation requirements that would operate separately from the current position limit, exemption and aggregation requirements for agricultural contracts set forth in part 150 of the Commission's regulations. While proposed part 151 borrows many features of part 150, there are notable distinctions between the two, including their methods of position limit calculation and treatment of positions held by swap dealers. The Commission seeks comment on what, if any, of the distinctive features of the position limit framework proposed herein, such as aggregate position limits and the swap dealer limited risk management exemption, should be applied to the agricultural commodities listed in part 150 of the Commission's regulations.*

I would rely on the old maxim "if it ain't broke, don't fix it." There is no need to change anything about the current rule for agricultural commodities spelled out in part 150. Both energy and agricultural commodities are plagued by passive speculation and both sections should have rules than ban or severely restrict passive investment strategies.

*11. The Commission is considering establishing speculative position limits for contracts based on other physical commodities with finite supply such as precious metal and soft agricultural commodity contracts. The Commission invites comment on which aspects of the current speculative position limit framework for the agricultural commodity contracts and the framework proposed herein for the major energy commodity contracts (such as proposed position limits based on a percentage of open interest and the proposed exemptions from the speculative position limits) are most relevant to contracts based on other physical commodities with finite supply such as precious metal and soft agricultural commodity contracts.*

The critical distinction that needs to be drawn is between consumable commodities, like crude oil futures, and other commodities, such as excluded commodities like S&P 500 futures. Even the S&P 500 and money invested in it exist in finite supply. Therefore distinguishing between derivatives on consumable commodities versus derivatives on financial instruments held for investment is critical. Precious metals are alternative forms of currency and considered a store of value. So the fact that they exist in finite quantities is less critical than the fact that they are not consumed. As an example 85% of all the gold ever mined is still in existence. Therefore precious metals do not need speculative position limits for the purposes of guarding against excessive speculation. All derivatives (finite or infinite, consumable or investable) need position limits for the purposes of guarding against manipulation. By this standard, base metals and soft agricultural products need speculative position limits to diminish, eliminate or prevent excessive speculation. Unfortunately the Commissions proposed rules do not address excessive speculation and only serve to mitigate manipulation.

*12. As discussed previously, the Commission has followed a policy since 2008 of conditioning FBOT no-action relief on the requirement that FBOTs with contracts that link to CFTC regulated contracts have position limits that are comparable to the position limits applicable to CFTC-regulated contracts. If the Commission adopts the proposed rulemaking, should it continue, or modify in any way, this policy to address FBOT contracts that would be linked to any referenced energy contract as defined by the proposed regulations?*

There would not be a need to change the policy. As the position limits on registered entities change then the FBOT's position limits must change as well as dictated by the policy. Hopefully Congress will pass legislation allowing the CFTC to establish an aggregate speculative position limit that applies to Foreign Boards of Trade as well as Designated Contract Markets and the Over-The-Counter markets.

*13. The Commission notes that Congress is currently considering legislation that would revise the Commission's section 4a(a) position limit authority to extend beyond positions in reporting market contracts to reach positions in OTC derivative instruments and FBOT contracts. Under some of these revisions, the Commission would be authorized to set limits for positions held in OTC derivative instruments and FBOT contracts. The Commission seeks comment on how it should take this pending legislation into account in proposing Federal speculative position limits.*

The Commission has a responsibility to police the commodities futures markets for fraud, manipulation and excessive speculation. Previous Commissions have shirked this responsibility and the American People have suffered as a result. The Commission should not delay doing its job and fulfilling its current responsibility based on the hope or expectation that its responsibilities will change in the future.

*14. Under proposed regulation 151.2, the Commission would set spot-month and all-months-combined position limits annually.*

*a. Should spot-month position limits be set on a more frequent basis given the potential for disruptions in deliverable supplies for referenced energy contracts?*

If the Commission observes that failure to update the spot month position limits results in disruptions then they should update the limits more frequently. As it stands today I am not aware that spot month disruptions have been a widespread problem.

*b. Should the Commission establish, by using a rolling-average of open interest instead of a simple average for example, all-months-combined position limits on a more frequent basis? If so, what reasons would support such action?*

Given that the proposed rule only tackles manipulation and does nothing to diminish, eliminate or prevent excessive speculation and in fact mechanically applying the manipulation formula actually opens the door for an increase in excessive speculation, I would argue that the less frequently position limits are adjusted the less likely they will lead to a chain reaction of ever increasing speculation. So I do not favor a rolling average approach. The only benefit to such approach would be if open interest were falling and an annual formula failed to capture a smaller position limit until the following year. But since speculation is the real problem in these markets and its only been increasing this seems like a small probability.

*15. Concerns have been raised about the impact of large, passive, and unleveraged long-only positions on the futures markets. Instead of using the futures markets for risk transference, traders that own such positions treat commodity futures contracts as distinct assets that can be held for an appreciable duration. This notice of rulemaking does not propose regulations that would categorize such positions for the purpose of applying different regulatory standards. Rather, the owners of such positions are treated as other investors that would be subject to the proposed speculative position limits.*

*a. Should the Commission propose regulations to limit the positions of passive long traders?*

Absolutely yes! They need to be banned or severely restricted because they consume liquidity and greatly damage the price discovery function of the markets.

*b. If so, what criteria should the Commission employ to identify and define such traders and positions?*

It will take some work to find a definition that Wall Street cannot evade but where there is a will there is a way. In principle the Commission needs to target someone who is entering positions with the stated intention to “invest” for the “long term.” They seek to maintain continuous directional exposure and they accomplish this by rolling their positions forward in time as they approach expiration. The swaps dealers could develop a product which is less mechanical and more subjective, but if someone has a position that is unidirectional 90%+ of the time and that is continuously maintained 90%+ of the time then that is a passive investment. I am happy to work with the Commission to develop a definition that will effectively identify and define passive investment.

*c. Assuming that passive long traders can properly be identified and defined, how and to what extent should the Commission limit their participation in the futures markets?*

These passive traders (long or short) should be banned. If that is politically unfeasible then a severe restriction of 10% the normal speculative position limit is called for. Passive speculators consume liquidity and damage the price discovery function. Therefore they provide no benefit to the derivatives markets and only do harm.

*d. If passive long positions should be limited in the aggregate, would it be feasible for the Commission to apportion market space amongst various traders that wish to establish passive long positions?*

I do not know what this means. Passive speculators should be individually limited until they are a tiny part of the markets.

*e. What unintended consequences are likely to result from the Commission’s implementation of passive long position limits?*

The consequence of putting a severe restriction or ban on passive speculators would be an increase in liquidity, a significant drop in price volatility and commodity prices that more reflect supply and demand reality. These are the intended consequences and I do not foresee any unintended consequences.

*16. The proposed definition of referenced energy contract, diversified commodity index, and contracts of the same class are intended to be simple definitions that readily identify the affected contracts through an objective and administrative process without relying on the Commission’s exercise of discretion.*

*a. Is the proposed definition of contracts of the same class for spot and non-spot months sufficiently inclusive?*

*b. Is it appropriate to define contracts of the same class during spot months to only include contracts that expire on the same day?*

*c. Should diversified commodity indexes be defined with greater particularity?*



I do not have any specific comments to these particular questions.

*17. Under the proposed regulations, a swap dealer seeking a risk management exemption would apply directly to the Commission for the exemption. Should such exemptions be processed by the reporting markets as would be the case with bona fide hedge exemptions under the proposed regulations?*

No. In order to enjoy the exemption, swaps dealers must report their positions in the swap markets along with dealing and trading activity directly to the CFTC on a monthly basis. Therefore they should apply directly to the CFTC for this exemption in the first place.

*18. In implementing initial spot month speculative position limits, if the notice of proposed rulemaking is finalized, should the Commission:*

- a. Issue special calls for information to the reporting markets to assess the size of a contract's deliverable supply;*
- b. Use the levels that are currently used by the exchanges; or*
- c. Undertake an independent calculation of deliverable supply without substantial reliance on exchange estimates?*

I do not have any specific comments to these particular questions.