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Subject: Public Comment: CFTC Meeting on Metals Markets (March 25, 2010)

First, I wanted to thank you for holding the Public Meeting on the Metals Markets on March 25, 2010, and for allowing me to provide testimony at that meeting. The efforts that you have all made to understand the unique issues related to the metals markets are clear. And, most importantly, the commitment you have shown to have an open dialog and present the information to the public via your excellent website resources is truly exceptional. The webcast and transcripts you have published on your website continue to provide an enormous service to the public. I very much appreciated the opportunity to have presented at that meeting, and I hope my testimony and answers to your questions were helpful.

It's certainly clear that the futures markets are a complex system which provide an enormously valuable and important service to the public. Providing a fair and reliable market to allow producers and consumers of commodities to manage their market-price risk is crucial to the efficient operation of our economy. Central to achieving this goal are two factors: (A) the fair and efficient discovery of prices, and (B) the guaranteed performance of counterparties.

Further, in commodities of finite supply, futures contracts that are physically deliverable have an critical additional unique characteristic. The seller of such a futures contract must have the capability to deliver the physical commodity, and thus the guaranteed performance of the seller is more than an economic guarantee. For the market to operate properly, there must be constraints in place to assure the physical delivery obligation of the seller is sound and guaranteed.

Thus, the size of the open interest in any delivery month must be a concern of the CFTC. Should the open interest get too large, there is the increased possibility of a severe price disruption to resolve that open interest. And, in the most extreme situation, there could be a failure-to-deliver default that would jeopardize the integrity of that futures contract. Every effort must be made by the CFTC to avoid this possibility.

Concentration of holdings is another substantial concern. To achieve the fair and efficient discovery of prices, the CFTC and the Exchanges must provide a level playing field to encourage the widest diversity of market participants. It's only through this diversity that price discovery can operation efficiently and fairly. Thus, the CFTC must be watchful for market participants that get disproportionately large, whether working individually or as a group. Such concentrated activity could illegally lead to price setting and market manipulation.

As an active participant in the COMEX silver and gold futures contracts, I have a keen awareness of the process of price movements throughout each day. In addition to making two-sided markets in these metals futures contracts nearly every day, I also make markets in agricultural, energy, interest rate, equity index, and currency futures. And, through my diverse experience, I have grown to understand some of the "personality" differences between each of the markets.

I'd like to focus my attention in this comment to the COMEX Silver market. In my written testimony, I suggested COMEX Silver position limit levels of 2,000 contracts for all-months combined, and the delivery-month position limit of 1,000 contracts. Additionally, the issue of possible exemptions to this limit must be handled with great care.

There should be NO exemptions to this limit other than for bona-fide hedgers, and such exemptions should be granted only on a limited basis upon demonstration of a bona-fide hedge needed for actual market-price risk in their business. An exemption on the LONG side should only be granted to an actual consumer of Physical Silver who has not yet secured a commitment for their silver needs at a fixed price. And an exemption on the SHORT side should only be granted to an actual producer of Physical Silver, and only to the extent that that silver is owned by the producer and has not been presold. Middle-men who actually own Physical Silver which has not been sold could also get an exemption on the SHORT side.

If the delivery-month position limit were for 1,000 contracts (which is 5,000,000 ounces), I believe this would satisfy nearly all of the actual needs of producers and consumers of silver around the world, WITHOUT the need for any exemptions. This is based on the worldwide production levels being approximately 600,000,000 ounces per year. As such, in the COMEX Silver futures market, the bona-fide need for an exemption should be quite rare.

Given the relatively small size of worldwide inventories, annual worldwide production, and annual worldwide consumption, I believe the CFTC should be quite concerned when open-interest gets too large and concentrated. The role that speculation plays in this market is very important to allow bona-fide producers and consumers to transfer their price risk. But, the CFTC must balance the desire for speculators to take large positions with the risk to the integrity of the market, both in the possibility of illegal price manipulation, and in the possibility of exposure to delivery default.

When individual positions are allowed to be over-sized relative the reality of the physical market, then the diversity of representation of various market participants suffers. And, the price discovery mechanism suffers. In this environment, the price action becomes less stable, and the liquidity dries up.

In COMEX Silver, there has been a persistent and large concentrated position on the SHORT side. This over-sized position creates a chilling effect on actual liquidity, as market makers (including myself) must adjust their orders to take this factor into account. And, true liquidity is thus reduced, defeating the goal of fair and efficient price discovery. Additionally, since this over-sized position is in the SHORT direction, it exposes the COMEX to an unreasonable and unnecessary risk of delivery default.

There has been some discussion about a possible consequence if position limits were implemented being that futures business might leave the regulated COMEX marketplace and move overseas or to less transparent OTC transactions. Of course, this should be a concern. However, in the current environment of instability of counterparty risk (and even the instability of various futures exchanges around the world), I believe market participants look extremely favorably at the benefits and strength of the COMEX exchange and the US regulated futures markets. Since COMEX silver is the most important worldwide price discovery mechanism for silver, I don't believe there is a big risk that market participants would leave this marketplace if proper position limits were put into place.

It's important to remember that being able to trade and hold futures position (either long or short) on a US regulated futures exchange is a privilege, not a right. And, the rules of the CFTC and the Exchanges must be followed, as those rules work to the advantage of the stability of the marketplace as whole. The stability of commerce in commodities of finite supply is most importantly dependent on a fair and efficiently operating futures market. Thus, market participants with over-sized positions which could jeopardize the stability of the futures markets should be viewed with great concern. The benefits of relatively small capital margin requirements to control large amounts of a commodity encourages speculators to want to take big bets via the futures markets. Thus, large positions in the futures markets by speculators is easy to understand. But, the

CFTC should guard carefully against this risk.

In summary, I'd like to reiterate the importance of properly-sized position limits in commodity markets of finite supply. I believe a formula that is based on open interest is not the correct way to go about setting position limits. The excessive open interest itself is part of the problem. I believe for COMEX Silver, a responsible position limit would be 2,000 contracts (or 10,000,000 ounces) for all-months combined, and 1,000 contracts (or 5,000,000 ounces) for delivery month.

Thanks for the hard work you are doing to make the futures markets more fair and efficient for all market participants.

-Mark Epstein.