Please- Reasonable limits and
NO EXEMPTIONS.

Sincerely,
Douglas Hall
3/21/10
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Omaha NE 68135

By: Gene Arensberg

Hon. Gary Gensler
Chairman, Commodities Futures Trading Commission
3 Lafayette Center
1155 21st St. NW
Washington, DC 50581

- Re: Meeting to discuss the establishment of position limits for precious metals futures markets scheduled for March 25.

Dear Chairman Gensler and Commissioners,

Certainly you all would agree with this statement: "No futures trader should be able to dominate the market or be able to achieve such an overwhelming size of positioning on one side of the market that it would intimidate the majority of traders in that market." Such a statement should be foremost in the policy totem pole of futures market regulators. However, the fact is that just such an egregious situation currently exists today in the U.S. precious metals futures markets, up to now apparently with the Commission's blessing.

The American people want to know why this Commission tolerates obvious and unfair market dominance by just a few well-connected, well-informed, well-funded and politically clever entities. Further, the American people look to you to end this inequity as one goal of this historic meeting.

Market dominance by a privileged few traders can only be accomplished if those few traders are granted a trading advantage, either by the rules themselves or by the regulator's granting of exemptions to the rules. Truly fair and free markets cannot exist so long as one or just a few traders are allowed trading dominance.

Problem Not Size Limits, Rather it is Exemptions to Limits

In the U.S. precious metals futures markets today an elite few traders are able to gain a trading advantage over all the other traders because the Commodities Futures Trading Commission (CFTC) and the futures exchanges routinely grant exemptions to position limits - in virtually unlimited size.

The statutes say generally that "bona fide hedgers" should be granted exemptions to position limits provided that the positions are for legitimate hedging purposes. But, Mr. Chairman and Commissioners, nowhere is it written that these exemptions should be given in such huge size that they overwhelm the trading of that market. Yet, that is exactly the condition we find in the gold and silver futures markets from time to time.

Because the Commission allows the mere possession of (or direct control of) physical metal inventory as a qualifying criteria for hedgers seeking exemptions to position limits, and since there are actually a very small number of entities who possess or control vast amounts of physical metal, there are in reality only a precious few traders capable of using and abusing the privilege of exemptions to size limits.

When the criteria for exemption looks only to a trader's claimed inventory for qualification, while ignoring the impact on the entire market an overly-large one-way position will ultimately have, then it is the exemption process and the implementation of it that perverts the price discovery mechanism of the futures markets.

Such overwhelmingly large exemptions to position limits have the direct result of allowing one side of the market to become dominant and very highly concentrated, with way too large a proportion of the actual trading dependent upon (and subject to the effects of) the actions of a very few traders the Commission deems "bona fide hedgers."

The problem is not, repeat not, an issue of the speculative position limits being too large. The Commission need not reduce the size of the current position limits if the Commission deems it necessary to impose its own limits rather than allowing the exchanges to regulate trading size.

Neither should the Commission bother with determining whether or not any particular trader is worthy of being granted such an obvious trading advantage. Instead, the Commission should grant no trader an advantage, period. The Commission should adopt new position limits which are blind as to the individual trader's needs or goals, looking only to the integrity and fairness of the market itself as the prime goal, and then rigorously enforce those new limits on both sides of the trading battlefield. (That is only if the Commission quits granting exemptions to position limits which are out of all proportion to the total open interest, as suggested below.)

We reviewed the prefatory questions supplied by Commission staff before preparing this memorandum. One question staff should have asked, but didn't is: **"Does allowing virtually unlimited size exemptions to position limits cause distortions in the futures markets or provide an unfair advantage to one side of the equation?"**

The answer to that question is "yes, obviously."

Futures Markets – Bullion Bank Playground

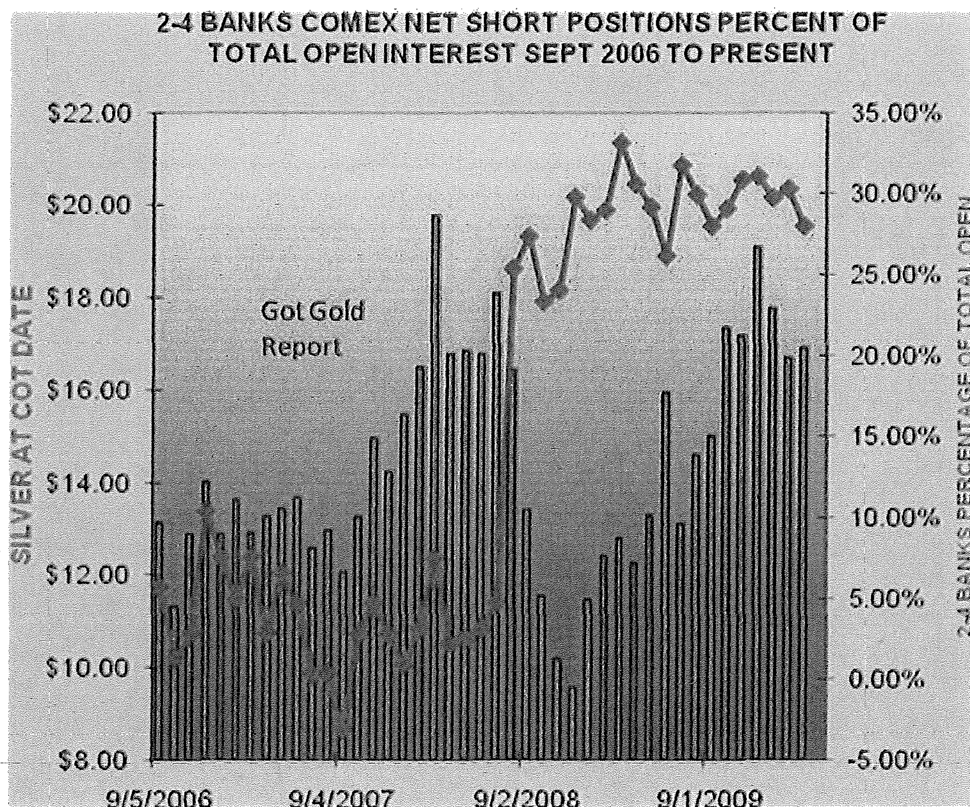
Again, the problem is not the current position limits. The problem is that some traders abuse (or at least have the opportunity to abuse) exemptions to those position limits and the possibility exists for those traders to dominate and intimidate the entire market because of that.

Position limits for futures are laughable so long as the Commission continues to allow virtually unlimited size "exemptions" to a very few "hedgers" in the metals markets. When traders on the speculative side of the market are strictly limited in their position taking (as they are now), while two very large U.S. based bullion banks are granted exemptions which allow them to take opposing positions 10, 15 or even 20 times the supposed speculative limits, clearly there is an imbalance of trading strength granted by this Commission to the hedging or short side of the trading pit.

The current exemption regimen therefore appears to favor the short, or hedging side.

As of March 2, for example, less than four and probably just two U.S. banks1[1] held a net short position of 30,286 contracts in the small silver COMEX futures market when the entire open interest on that market was 108,248 contracts open (just two banks holding 28% of the entire market net short). 1[2] Those two bank's net short position dwarfs and overwhelms the trading "horsepower" of the largest speculative traders where even the four largest combined longs amounted to 14.4% of the open interest.

The U.S. banks' net short positioning relative to the total open interest of the COMEX silver market is plotted in the graph just below.



Note, please, that the huge jump in U.S. bank net short positioning for silver occurred at roughly the same time as the Bear Stearns "take-under" in 2008. Note also that the overly-large concentration of net short positioning by these two banks continued at least through March 2, 2010. Just two banks hold over one-quarter of all the COMEX action net short. No other trader or pair of traders even comes close to that market dominance.

We believe the U.S. banks are most likely JP Morgan Chase and HSBC, although their identity is guarded and kept from the American people by the Commission by convenient statute. However, through the dedicated research of others, particularly the Gold Anti-Trust Action Committee (GATA), led by William J. (Bill) Murphy and Chris Powell, we believe there is little question these bullion banks are directly responsible for the overwhelmingly large interests consistently on one side, the short side, of the bullion markets.1[3]

While we would not openly accuse any particular bank of using position-intimidation or of attempting to manipulate prices lower, we would point out to this Commission that allowing just one or two traders virtually unlimited size in the futures markets is tantamount to encouraging that trader to use the weight of its own trading to achieve a price outcome favorable to them and contrary to the price discovery mechanism the futures markets are supposed to be.

Bullion Banks "do it" Because They Can

In Texas English: To us it seems the CFTC winks at position limits when it comes to a few preferred players. That is why so many now believe that those elite bullion banks consider the COMEX as their own trading playground. It is like allowing JP Morgan to use a battleship and an aircraft carrier against the natives using bows and arrows in the small COMEX silver frog pond.

While one might argue that an entity holding a little more than a quarter of the open interest net short is not dominant or intimidating because that would mean that three-quarters of the market is left, we would

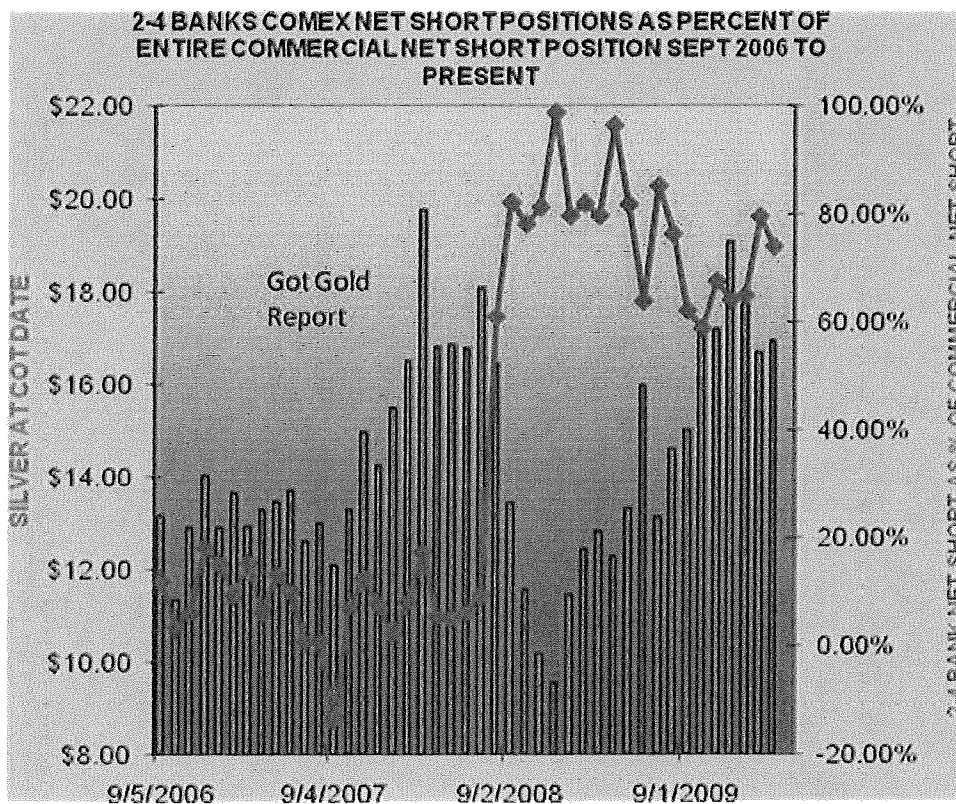
argue otherwise. Primarily because under the rules today no one is granted an equally powerful exemption to the position limits for the opposite side of the market, the long side.

Therefore, if JP Morgan wanted to or felt compelled to, it certainly could dominate or intimidate the rest of the market participants simply by taking ever larger net short positions until the real market demand has been artificially and temporarily sated. They are able to by virtue of their ability to claim an exemption to position limits purely because they hold or control metal inventory in excess of the entire market open interest for silver.

No trader on the long side has that "weapon" and everyone knows it. Only a very few bullion banks can use that weapon; they do so with this Commission's blessing and everyone knows it. There is nothing equitable about that.

Further, the above graph compares the two U.S. bank's net short position to the total open interest of the COMEX on March 2, 2010. In order to understand just how concentrated that U.S. bank positioning really is, we need to see it in terms of all the commercial net short positioning. It is there where we see just how dominant these two entities are in the COMEX silver market.

As of March 2, the two U.S. banks held 135 silver contracts long and 30,421 contracts short for a net short position of 30,286 contracts. On that same date, all traders classed by the CFTC as "commercial," all of them, held 31,034 contracts long and 71,974 contracts short for a collective commercial net short position of 40,940 contracts.1[4] Therefore just these two well-connected bullion banks held a staggering 74% of all the commercial net short positioning on the COMEX. The two banks' net short positioning relative to all traders the CFTC classes as commercial is shown in the graph below.1[5]



At times during the last year and a half these two U.S. banks have been responsible for as much as 99% (not a misprint) of all the commercial net short positioning on the COMEX.

In no other market is there anything close to this kind of overwhelmingly concentrated positioning on either side of the trading pit. The only reason it is possible is because this Commission allows it and apparently approves of it. There is a similar, but somewhat less dominant situation in the much larger gold futures market, but we will confine our comments to silver for this memo.

In short (no pun intended), the current exemption policy allows an imbalance in the futures markets which can only be corrected by placing limits on the number of contracts ANY trader may hold, regardless of their bias, measured as a percentage of the total open interest at any given time. Limits which recognize that the futures market is not large enough to allow unlimited exemptions for traders who hold inventories too large to hedge on this bourse.

Time for a Level Playing Field

Speaking as to question number 6a in the staff memorandum, which asked: *"If the Commission were to establish position limits for metals derivatives markets, what types of exemptions from such limits should be permitted?*

a) The statute states exemptions should only be granted to bona fide hedgers. What should be the qualifying factors for an entity to be determined to be a bona fide hedger?"

The Commission should ignore a trader's inventory of metal as a qualifying tenant of an exemption because there are only a very few traders who hold or control vast amounts of precious metals and the ones that do - control an overwhelmingly large amount of the metal. Therefore they are able to claim an exemption for virtually any size in the futures markets and are able or have the potential to overwhelm and intimidate the opposing side of the market. The futures market is not large enough to allow such beneficial treatment to a few giant bullion banks.

Rather than allowing a few large holders of metal to dominate a market, position limits should be based on the market's relative size only, without regard to the trader's advantages or disadvantages in that market. The market should be blind as to the trader's needs. It should instead be concerned with the integrity and fairness of the market itself.

Position Limits Should Favor No One

In order to insure a fair market for all participants, ALL participants, even bona fide hedgers, should be restricted to no more than a reasonable percentage of the open interest at any one time. Both in the spot month and in deferred or future months.

Just as no single trader (or cabal of single-minded traders) should be able to amass a dominant position of tens of thousands of contracts on the long side, neither should any one trader be able to do so on the opposite side. There are other, larger and less regulated markets in which such large players can hedge via swaps, options, forwards, over-the-counter derivatives, etc.

The Commission should not let the arguments of a few very large players determine its policy for the entire market.

As a suggestion for the silver market, the limits could be set initially at no more than 10% of the open interest or 10,000 contracts (whichever is the higher) for all participants, long, short or spreading, in all contract months, with no more than 3,000 contracts in the spot month.

Then, as or if the open interest increases beyond 100,000 contracts, in minimum 10,000 contract marks, all traders would be able to increase the position size limit by 1,000 contracts (10% of the increase in open interest) in all months (and across all CFTC regulated markets), or an additional 300 contracts (10% of the increase in the open interest) in the spot month, so that in no case could any trader hold more than 10% of the market in any trading period. Again, this assumes that the Commission no longer allows any trader an overly large exemption to the limits.

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Otherwise, if the Commission allows any trader an exemption to size limits, for any reason, the limits for traders on the opposing side should be increased by the exact same amount. Otherwise the potential for abuse of those exemptions will follow.

Don't Let Bankers Determine CFTC Policy This Time

In conclusion, granting exemptions to position limits without regard to the imbalances and market intimidation such exemptions cause is the prime issue this Commission should focus on and correct now.

We very much hope that you, Chariman Gensler, and all the CFTC Commissioners will take this historic opportunity to finally bring balance to the U.S. precious metals futures markets and end the abuse of it by a few powerful actors.

This Commission should immediately adopt fair position limits for the precious metals markets which will no longer favor a few large bullion banks and instead restore a level playing field for all market participants.

To do otherwise now will confirm that this Commission is partial to the bullion banks and contrary to the will of the American people. To do otherwise will perpetuate the common impression of the U.S. futures markets as a playground for miscreant bullion banks with this Commission unable or unwilling to intercede.

If we can be of any assistance to you or your staff in formulating the new, fair trading policy, do not hesitate to contact us.

Respectfully,

Gene Arensberg
Got Gold Report
GotGoldReport.com
(Address sent separately)

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