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David A. Stawick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
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Submitted Electronically

March 28, 2011

Re: Position Limits for Derivatives RIN numbers 3038-AD15 and 3038-AD16

Dear Secretary Stawick:

The non-profit consumer advocacy organization Food & Water Watch respectfully submits the following comments to the U.S. Commodity Futures Trading Commission on the proposed rules governing position limits for derivatives promulgated under the Dodd-Frank Wall Street Reform Act of 2010.[1] The Commodities Exchange Act was designed to ensure that the core price discovery and risk management functions of the commodities and derivatives markets are not distorted by excess speculation and market manipulation. These markets provide vital functions for agricultural producers as well as consumers by reducing the impact of unwarranted price volatility and providing some certainty for farmers, food manufacturers and consumers.

The proposed rule fails to address the statutory mandate to set position limits that can prevent excess speculation in commodity futures and derivatives markets. The proposed rule establishes position limits that are far too high and would continue to allow large investors and traders to distort the markets and exert upward pressure on prices from index funds. In many cases, the formula to set position limits under the proposed rule would actually be higher than the existing position limits.

Raising position limits is entirely unnecessary given the current level of financial flows on the physical commodities markets. There is no evidence that commodities' futures markets are suffering from inadequate liquidity that would warrant higher position limits. The final rule must establish lower position limits to prevent excess speculation in these markets.

Furthermore, the proposed rule effectively exempts many derivatives from position limits. The proposed rule delays establishing position limits on swaps transactions.[2] The Dodd-Frank Act directs the Commission to establish position limits on swaps with

[1] 76 Fed. Reg. 4752.
[2] 76 Fed. Reg. 4753.

significant price discovery functions.[3] It also excludes commodity index funds from the definition of the referenced contracts that would be subject to future position limits for swaps with significant price discovery function.[4] The Commission should act to establish position limits for swaps immediately and these limits should include commodity index fund investments that have had a significant impact on price discovery in the commodity futures market over the past five years.

Other provisions of the proposed rule are stronger and merit support. Although the position limits themselves are too high, the application of position limits across trading platforms and the aggregation of accounts is an important step forward to prevent individuals and traders from utilizing multiple trading platforms or exchanges to exceed position limits. Importantly, the application of account aggregation standards would begin to address the effects of index fund investments in commodities markets by including many positions in these commodities pools in the aggregate position limits. Food & Water Watch also recommends that the Commission adopt comparable position visibility standards for agricultural commodities and soft agricultural commodities as it has proposed for energy and metals in order to assess the impact of larger traders on agricultural commodity markets.

During the past five years, a considerable influx of new futures and derivatives investors, primarily in the form of commodity index funds and exchange traded derivatives funds, swamped the commodity futures markets. These new investors increased price volatility, undermined the price discovery and risk management functions of the markets for *bona fide* hedgers and end users, and significantly contributed to the commodities' price bubbles of 2008.

The volatility and price swings were unrelated to supply and demand fundamentals. Many academics, experts and observers attributed these changes to the excess speculation by new index fund participation. The rising prices in agricultural commodities increased the price of food in the United States, undermined the ability of U.S. farmers to access the futures markets, and contributed to rising international grain prices that made millions of people in the developing world go hungry. In 2011, it appears that excess speculation is again driving up commodity prices, harming U.S. consumers, farmers and compromising food security in the developing world. The Commission should act expeditiously to restore strong position limit safeguards to prevent excess speculative activity from distorting the marketplace and endangering the public interest.

The Importance of Strong and Effective Position Limits

Strong position limits are the best safeguard against excess speculation in the futures and derivatives markets. The Commodities Exchange Act recognizes that excessive speculation can cause "sudden or unreasonable fluctuations or unwarranted changes in

[3] §737(a)(4)(4). Dodd-Frank Wall Street Reform and Consumer Protection Act. Pub. L. 111-203. 124 Stat. 1723. July 21, 2010.
[4] Proposed rule §151.1. 76 Fed. Reg. 4768.

the price" of commodities that can create an "undue and unnecessary burden on interstate commerce."[5]

Position limits prevent commodities' traders from amassing such large pools of futures or derivatives contracts that the very size of the holding controlled by a single trader could impact the pricing or volatility of commodities markets. In 1926, the Federal Trade Commission noted "The very large trader by himself may cause important fluctuations in the market" and "if he is large enough he can cause disturbances in the market which impair the proper functioning and are harmful to producers and consumers."[6] Speculative position limits were first established in 1936 to prevent excess speculation from creating extreme volatility in agricultural prices.[7] The Commission notes in the proposed rule that "Large concentrated positions in the physical commodity markets can potentially facilitate price distortions."[8]

Position limits reduce the potential that large traders can hold significant concentrations of futures or derivatives contracts that can distort the markets by ensuring "the participation of a minimum number of traders that are independent of each other and have different trading objectives and strategies."[9] The size of commodity index investments alone compared to commodity markets can exacerbate price swings.[10] The Dodd-Frank Act delineates the four goals of establishing position limits:

> [T]o diminish, eliminate, or prevent excess speculation; to deter and prevent market manipulation, squeezes, and corners; to ensure sufficient market liquidity for *bona fide* hedgers; and to ensure that the price discovery function of the underlying market is not disrupted.[11]

Over the past several decades, the strength of position limits was greatly diluted. In 1987, the Commission determined that many swaps and derivatives firms operating in the futures markets were effectively hedgers, and should be considered commercial traders instead of non-commercial speculators subject to position limit requirements.[12] In 1991, the Commission exempted commodity-based swaps dealers who used real commodity contracts to sell commodity index funds on the over-the-counter swaps markets.[13] These changes effectively exempted many financial firms from any position limits and allowed large financial speculators to dominate agricultural and food commodity markets. In 1991, the Commission began to approve self-regulation with exchange-based

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[5] 7 USC §6a(a).
[6] 76 Fed. Reg. 4754 at note 14.
[7] 74 Fed. Reg. 12283.
[8] 76 Fed. Reg. 4755.
[9] 76 Fed. Reg. 4755.
[10] Baffes, John and Tassos Haniotis. World Bank Development Prospects Group. "Placing the 2006/08 Commodity Price Boom into Perspective." World Bank Policy Research Working Paper 5371. July 2010 at 9.
[11] §737(a)(4)(3)(B)(i-iv).
[12] CFTC 2008 at 13-14.
[13] CFTC 2008 at 14.

accountability limits that replaced position limits for some metals starting in 1992 and other metals and soft agricultural derivatives in 2001.[14]

The Commission has also granted no-action letters to some traders, allowing them to exceed position limits. In 2006, the Commission permitted the Deutsche Bank Commodity Index Tracking Fund to exceed the position limits for corn and wheat to reduce the commercial risk of its passive index investment fund.[15] Deutsche Bank contended that exceeding position limits posed no danger of speculation although it admitted its corn and wheat positions could increase as more investors bought into the index. Again in 2006, the Commission approved a no-action letter to an unnamed index fund that asked to hold 27,000 corn contracts, 15,000 soybean contacts and 13,000 wheat contacts (for all-months combined holdings).[16] By 2006, the non-traditional hedgers that were granted position limits exemptions represented a significant share of the long-term futures contracts.[17] In 2009, the Commission rescinded both of these no-action letters and Commission Chairman Gary Gensler noted "position limits should be consistently applied and vigorously enforced."[18]

Recent Excess Speculation in Agricultural Markets has Exacerbated Volatility and Undermined Price Discovery

The historic rise in agricultural and energy commodities during 2008 and again in 2011 was significantly attributable to excessive speculation in commodity derivatives and futures markets. The volume of trading in commodities futures markets has indisputably surged in recent years, far in excess of changes in the supply of agricultural products or the demand for food, feed and biofuel stocks. The Federal Reserve Bank of St. Louis documented that the "massive" growth in agricultural derivative trading "far outstrips the growth in commodity production and the need for derivatives to hedge risk by commercial producers and users of commodities."[19] A range of academic and industry experts have demonstrated the tight linkages between rising commodity futures speculation and commodity prices.

Despite surging commodities derivatives investments and corresponding price jumps, many observers have discounted the role of speculative derivatives trading on physical commodity prices. In 2008, the International Monetary Fund reported "there is little concrete evidence that rising speculation or increased investor interest in commodities as

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[14] 76 Fed. Reg. 4755.

[15] U.S. Commodities Futures Trading Commission. "CFTC Letter No. 06-09. Re: Request for No-Action Relief with Regard to Commodity Exchange Act Section 4a and Commission Regulation 150.2, Speculative Position Limits for Certain Corn and Wheat Positions." May 5, 2006.

[16] U.S. Commodity Futures Trading Commission. "CFTC Letter No. 06-19. Re: Request for No-Action Relief with Regard to Commodity Exchange Act Section 4a and Commission Regulation 150.2, Speculative Position Limits for Certain Soybean and Wheat Futures Positions." September 6, 2006.

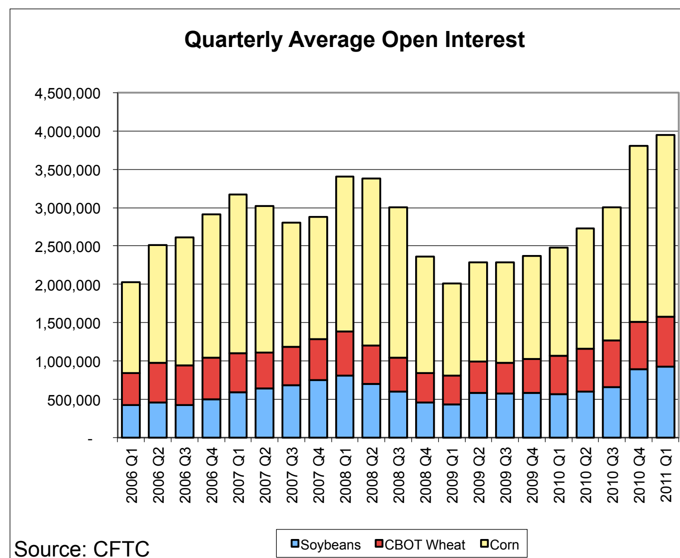
[17] 74 Fed. Reg. 12285.

[18] CFTC. Press release. "CFTC withdraws two no-action letters granting relief from federal speculative position limits on soybeans, corn and wheat contracts." Release 5695-09. August 19, 2009.

[19] Basu, Parantap and William T. Gavin. "What explains the growth in commodity derivatives." *Federal Reserve Bank of St Louis Review*. January/February 2011at 37-38.

alternative assets had a systemic or lasting impact on prices."[20] A task force created by international commodity and stock market regulators commented in 2009 "economic fundamentals [such as changes in supply and demand], rather than speculative activity, are a plausible explanation for recent price changes."[21] A 2009 CME Group white paper reported that the notion that excess speculation drove high commodity prices is "unsupported by empirical or legitimate economic analysis."[22]

But the 2008 rapid rise in prices across all agriclutural commodities cannot be explained by market fundamentals alone. The International Food Policy Research Institute noted, "Changes in supply and demand fundamentals cannot fully explain the recent drastic increase in food prices."[23] The World Bank analyzed the supply and demand fundamentals during the 2008 food crisis – including increased demand from emerging economies, rising use of biofuels, weather-related supply disruptions and macroeconomic changes – and found that these forces were minor and even biofuels had considerably less impact than predicted.[24]



Commodity futures trading has ricocheted up and down in recent years, creating significant price spikes and declines. Prior to 2005, the volume of agricultural commodity trading and the number of open interest contracts was fairly steady, in part because it was mostly used by agricultural commercial traders with a physical interest in the contracts. Starting in 2006, both the volume of trading and the level of open interest began to rise significantly for agricultural commodities.

Between the first quarter of 2006 and the first quarter of 2008, the open interest in corn rose 70 percent, open interest in soybeans rose 89 percent and the open interest in Chicago wheat rose 40 percent.[25] After the economic downturn took hold and Lehman Brothers collapsed, commodity investments retreated nearly as fast. Between the second

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[20] International Monetary Fund. *World Economic Outlook*. October 2008 at 15.
[21] International Organization of Securities Commissions Technical Committee. "Report of the Task Force on Commodity Futures Markets." March 2009 at 7.
[22] CME Group. "Excessive Speculation and Position Limits in Energy Markets." July 21, 2011 at 2.
[23] Robles, Michael, Miximo Torero and Joachim von Braun. International Food Policy Research Institute. "When Speculation Matters." IFPRI Issue Brief 57. February 2009 at 2.
[24] Baffes, John and Tassos Haniotis. World Bank Development Prospects Group. "Placing the 2006/08 Commodity Price Boom into Perspective." World Bank Policy Research Working Paper 5371. July 2010 at 18.
[25] CFTC. Commodity Index Supplement. Accessed March 2011.

quarter of 2008 and the second quarter of 2009, open interest in corn fell 41 percent, soybeans fell 16 percent and wheat fell 19 percent. Since then commodity investments have been rising. Between the second quarter of 2009 and the fourth quarter of 2010, open interest in corn rose 78 percent, soybeans rose 53 percent and wheat rose 50 percent.

The increased volume of trading in commodities futures coincided with sharp spikes in the spot and export prices of food commodities. The commodity price escalation between 2002 and 2008 was the steepest, most pronounced commodity price surge in decades — prices were higher for more commodities and for a longer period of time.[26] The international price of corn, wheat and rice all grew about three-fold between January 2005 and the spring of 2008.[27] These price increases closely followed record-breaking prices in the commodity futures markets. In 2008, Chicago wheat futures, rice futures, corn futures and soybean futures all hit new records.[28] The 2008 price run-up was accompanied by unprecedented price volatility.[29] In early 2008, wheat and soybean volatility was triple the historical levels and corn price volatility was twice as high.[30]

More evidence is emerging that excess speculation contributed to the sharp rise in commodity prices between 2006 and 2008. In 2010, an IFPRI study found that price changes in the agricultural futures markets lead to price changes in the spot markets and that the causal link had grown stronger in recent years.[31] Other studies have documented the link between commodity index investors and the rising price of agricultural commodities. The U.S. Senate Permanent Subcommittee on Investigations reported that index investors in the wheat market rose seven-fold from 30,000 contracts a day in 2004 to 220,000 contracts a day in mid-2008 and this surging investment drove up the cost of wheat.[32] A 2011 paper by economists from Princeton University and the Renmin University of China found that index funds and the financialization of commodities markets led to a "synchronized price boom and bust of a large set of seemingly unrelated commodities."[33] A 2009 United Nations Conference on Trade and Development paper found that index fund investments affected the prices of agricultural commodities in the

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[26] United Nations Conference on Trade and Development. "The Global Economic Crisis: Systemic Failures and Multilateral Remedies." UNCTAD/GDS/2009/1. 2009 at 23.
[27] United Nations Food and Agriculture Organization, Global Information and Early Warning System. National Basic Food Prices database. Available at http://www.fao.org/giews/pricetool/. Accessed March 2009.
[28] Commodity Futures Trading Commission. "Staff Report on Commodity Swap Dealers & Index Traders with Commission Recommendations." September 2008 at 9-10 and note 10 at 10.
[29] 74 Fed. Reg. 12285.
[30] Young, John E. International Food Policy Research Institute. "Speculation and world food markets." *IFPRI Forum*. July 2008 at 11.
[31] Hernandez, Manuel and Maximo Torero. International Food Policy Research Institute. "Examining the Dynamic Relationship between Spot and Future Prices of Agricultural Commodities." IFPRI Discussion Paper 00988. June 2010 at 18.
[32] U.S. Senate Permanent Subcommittee on Investigations, Committee on Homeland Security. "Excessive Speculation in the Wheat Market." June 24, 2009 at 2 and 5.
[33] Tang, Ke and Wei Xiong. Remnin University of China; Princeton University and NBER. "Index Investment and Financialization of Commodities." January 2011 version at 27.

year before they hit their peak.[34] A 2010 World Bank paper reported that "Index fund activity (one type of 'speculative' activity among the many that the literature refers to) played a key role during the 2008 price spike."[35] These studies amply demonstrate the causal link between index fund investment and excess speculation on agricultural commodity prices. There are a raft of similar studies that document the same causal linkages with rising energy commodity prices.

Excess Speculation in Agricultural Markets Burdens Commerce and Harms the Public Interest

Excess speculation that leads to unreasonable price fluctuations creates an undue and unnecessary burden on interstate commerce.[36] The congressional report accompanying the 1936 Commodities Exchange Act described the law's purpose as providing "a measure of control over those forms of speculative activity which too often demoralize the markets to the injury of producers and consumers and the exchanges themselves."[37] Indeed, evaluating the benefits of any proposed Commission regulation includes assessing the benefits to "market participants and the public" and "other public interest considerations."[38] The excess speculation in agricultural commodities markets presents an undue burden to end-users such as farmers and food manufacturers who rely on these markets to hedge their risks but also to the public interest and consumers who rely on these markets to reduce excess volatility in food prices.

Farmers

Most farmers do not participate directly in the futures market. Instead they contract to sell their crops to local grain elevators or cooperatives that then sell these future crops on the futures markets. Elevators link farmers to the commodity markets and help growers manage their price risks.[39] All participants in the regulated commodity exchanges are required to post margin for the contracts they are selling or buying. These margins are a percentage of the commodity future price, so as the price changes, the margin requirement changes as well. In 2008, as prices rose steadily, grain elevators were repeatedly required to replenish their margin deposits. In March 2008, almost a quarter of lenders reported that local grain elevators were having difficulty making their margin calls, especially in the southern wheat belt of Kansas, Colorado, Oklahoma and New Mexico.[40] These elevators tapped their credit lines from banks to refill their margin accounts at the exchanges.[41]

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[34] Mayer, Jörg. United Nations Conference on Trade and Development. "The Growing Interdependence between Financial and Commodity Markets." UNCTAD/OSG/DP/2009/3. No. 195. October 2009 at 22.
[35] Baffes and Haniotis at 18.
[36] 76 Fed. Reg. 4754.
[37] 76 Fed. Reg. 4754 at note 15.
[38] 76 Fed. Reg. 4764.
[39] Henderson, Jason and Nancy Fitzgerald. Federal Reserve Bank of Kansas City. "Can Grain Elevators Survive Record Crop Prices?" *Main Street Economist*. Vol. III, Iss. III. 2008 at 1.
[40] George, Esther. Senior Vice President, Federal Reserve Bank of Kansas City. CFTC Agricultural Markets Roundtable at 228.
[41] Henderson and Fitzgerald at 3.

Farmers were having difficulty forward contracting with elevators that were running out of credit needed to borrow funds from banks both to pay for future crops and to meet their margin calls on the futures market.[42] Some elevators and co-ops modified the marketing options they offer to farmers, including eliminating long-term forward sales or hedge contracts to producers.[43] In 2008, the Federal Reserve Bank of Kansas City found that a third of farmers reported that their regular crop buyer stopped all advance purchasing arrangements.[44] So as prices have risen, many farmers could not even sell their crops at these higher prices because elevators could not afford to buy the crops or meet margin requirements to sell the crops, and could not access enough credit to participate in the overheated futures market.

U.S. Consumers

Excess speculation contributed to higher consumer food prices since 2008. The rising price of food has been especially damaging during the economic downturn as unemployment made food even more difficult for many families to afford. As commodity prices rose in 2008, some food manufacturers increased their prices and others reduced the size of their packages, effectively raising consumer prices.[45] U.S. grocery store food prices rose by 6.6 percent in 2008, the biggest increase since 1980, and cereal and bakery prices rose by 11.7 percent.[46]

The U.S. Department of Agriculture reported that food insecurity in the United States – hunger – rose sharply and reached its highest level in history in 2008.[47] A 2009 Hormel Foods survey reported that a quarter of U.S. adults had eaten less to ensure their children had enough to eat.[48] Seventeen million U.S. households (about 1 in 7 households) containing 17 million children (1 in 4 children) faced food insecurity in 2009, according to USDA.[49] Rising food prices are especially damaging to lower income Americans. The lowest earning 40 percent of households spend about 15 percent of their income on food.[50]

Global Hunger

In the developing world, rising food prices can be calamitous because many families spend more than half their income on food; the poorest families spend nearly three

[42] Buis, Tom. President, National Farmers Union. CFTC Agricultural Markets Roundtable at 142.
[43] Jacob, Andrew. USDA Farm Credit Administration. CFTC Agricultural Markets Roundtable at 238-239.
[44] Henderson and Fitzgerald at 4.
[45] Cooke, Kristina. "General Mills profit up, sees costs rising faster." *Reuters*. March 19, 2008.
[46] U.S. Bureau of Labor Statistics. "Consumer Price Index: December 2008." January 16, 2009 at 2.
[47] Smith, Rod. "Hunger is historic." *Feedstuffs*. November 23, 2009.
[48] Hormel Foods. Press release. "Americans struggle to feed their families, know others who needed donated food, according to the 2009 Hormel Hunger Survey." November 11, 2009.
[49] Nord, Mark et al. USDA Economic Research Service. "Household Food Security in the United States, 2009." ERS Report No. 108. November 2010 at 6-7.
[50] U.S. Bureau of Labor Statistics. Consumer Expenditure Survey 2009. Table 45. October 2010.

quarters of their income on food.[51] According to the IFPRI, commodity speculation can fuel "unwanted price fluctuations that can harm the poor and result in long-term, irreversible nutritional damage, especially among children."[52] During 2008, the United Nations Food and Agriculture Organization estimated that the high price of food made an additional 130 million people worldwide malnourished.[53] After falling in 2009 and early 2010, global food prices are rising again, in part due to excess speculation. By February 2010, the FAO world food price index exceeded its level at the height of the food crisis in 2008 – making food twice as expensive as it was between 2002 and 2004.[54] UNICEF reports that in the developing world, food prices only fell slightly in 2009 and are now on a trajectory to exceed prices during the 2008 food crisis.[55]

Rising food prices can also threaten political stability and contribute to civil unrest. In 2008 skyrocketing food prices fueled civil distubances and riots from Bolivia to Cameroon to Indonesia that threatened the stability of 33 countries.[56] In April 2008, the Haitian government collapsed after more than a week of rioting over high food prices.[57] So far in 2011, rising food prices led to protests in Algeria, Egypt, Haiti, Jordan, Morocco, Mozambique, Tunisia and Yemen.[58]

Commission Authority to Establish Position Limits

The Commodities Exchange Act authorizes the Commission to establish and fix limits on the number of contracts that any individual or firm can hold in specific commodities in order to prevent the burden of excess speculation.[59] The Commission need not prove that the burden from price fluctuations is directly attributable to excess speculation exists or is likely to unfold in order to establish position limits.[60] Prior to the Dodd-Frank Act, the Commodity Exchange Act authorized the Commission to set position limits on any commodity.[61] The Dodd-Frank Act affirmatively directed the Commission to establish position limits:

> The Commission shall by rule, regulation, or order establish limits on the amount of positions, as appropriate, other than *bona fide* hedge positions,

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[51] Ivanic, Maros and Will Martin. "Implications of Higher Global Food Prices for Poverty in Low-Income Countries." World Bank Development Research Group Trade Team. Policy Research Working Paper 4594. April 2008 at 2.
[52] Robles et al. at 7.
[53] Sheeran, Josette. Executive Director, United Nations World Food Programme. Testimony submitted to the U.S. Senate Committee on Foreign Relations. May 14, 2008 at 20.
[54] United Nations FAO. Food Price Index. Available at www.fao.org/worldfoodsituation/ accessed March 2011.
[55] Ortiz, Isabel, Jingqing Chai and Matthew Cummins. UNICEF. "Escalating Food Prices: The threat to poor households and policies to safeguard a recovery for all." February 2011 at 5.
[56] Cleland, Gary. "Food riots could spread, UN chief warns." *Daily Telegraph* (UK). April 14, 2008; "As Food Prices Soar, U.N. Calls for International Help." *Newshour with Jim Lehrer*, April 23, 3008
[57] Delva, Joseph Guyler and Jim Loney. "Haiti's government falls after food riots." *Reuters*. April 12, 2008.
[58] Ortiz, Isabel et al. at 1.
[59] 7 USC §6a(a).
[60] 76 Fed. Reg. 4754.
[61] 7 USC §6a(a).

> that may be held by any person with respect to contracts of sale for future delivery or with respect to options on the contracts or commodities traded on or subject to the rules of a designated contract market.[62]

The Commission is authorized to set position limits to "diminish, eliminate, or prevent" the burden of excess speculation to prevent "sudden or unreasonable changes in price" irrespective of any manipulative intent.[63] The Commission is authorized to establish position limits as a proactive protective measure in order to ensure that future excess speculation does not distort the marketplace.[64] The Commission should use this authority to establish meaningful, strong position limits over commodities futures and derivatives trading as well as commodity swaps and commodity index fund investments.

Spot-Month Position Limits §151.4(a)

The Commission proposes to set spot-month limits at 25 percent of the estimated deliverable supply.[65] These limits may be too high to prevent excess speculation from distorting the markets in the month preceding the delivery period. The Commission contends that this spot-month limit could reduce the risk of corners and squeezes towards the delivery point of futures contracts or in referenced swaps contracts tied to the deliverable commodity.[66]

While this limit may be appropriate to reduce fraud and manipulation from corners and squeezes, position limits are needed to prevent excess speculation irrespective of manipulative intents. Any ancillary benefits of reducing the tendency for market manipulation provide additional protections for market participants, but position limits must be established to combat excess speculation.

The proposed 25 percent of estimated deliverable supply might not be sufficiently stringent to prevent excess speculation. It allows a single trading firm to control one quarter of the practical marketplace during the month of delivery – four traders could theoretically control 100 percent of the deliverable supply under the proposed rule. In 2001, the Commission brought an administrative complaint against a pork bellies trader who exceeded the spot-month position limit of the Chicago Mercantile Exchange by 150 percent when the spot-month position limit was 50 contracts for an estimated deliverable supply of 399 contracts.[67] In this case, the spot-month position limit was 12.5 percent of the estimated deliverable supply – half the proposed spot-month position limit. The Commission should consider lowering the spot-month position limit.

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[62] §737(a)(4). Dodd-Frank Act. Pub. L. No. 111-203. 124 Stat. 1722. July 21, 2010.
[63] 76 Fed. Reg. 4754.
[64] 76 Fed. Reg. 4754.
[65] Proposed rule §151.4(a)(1). 76 Fed. Reg. 4770.
[66] 76 Fed. Reg. 4757.
[67] CFTC. In the Matter of Andy Saberi. United States of America before the Commodity Futures Trading Commission. CFTC Docket No. 01-11. October 23, 2002.

Non-Spot Month, Single Month and All-Months Combined Position Limits §151.4(d)

The Commission's proposed rule would establish position limits on non-spot months in the second implementation phase. The single month and all-months combined position limits would be 10 percent of the open interest for the first 25,000 contracts and 2.5 percent of additional open interest.[68] The proposed position limits are far too high to prevent excess speculation.

In most cases, the proposed formula-based position limits exceed the current position limits for agricultural commodities. Under the proposed formula, position limits for feeder cattle, live cattle, class III milk, and sugar more than double.[69] Lean hogs position limits would rise by 90 percent and the coffee and rough rice position limits would rise by more than a third (36 and 39 percent, respectively).[70] The corn, Chicago wheat and soybean position limits would nearly double under the proposed formula if the agricultural legacy position limits are not maintained (see below).

The Commission recognizes that these position limits are high. The Commission notes that the position limits "as proposed, are intended as high levels that speculators are likely to acquire in order to avoid disrupting or interfering with beneficial speculative trading."[71] The proposed rule states that "the proposed framework sets high position levels that are reflective of the largest positions held by market participants."[72]

These high limits allegedly "are purposely designed to be high in order to ensure sufficient liquidity for *bona fide* hedgers and avoid disrupting the price discovery process."[73] There is little evidence that there is insufficient liquidity in commodity markets and ample evidence that excess speculation is already disrupting the price discovery function of the market as well as preventing *bona fide* hedgers from exercising necessary risk management market functions.

Indeed, the Commission and the exchanges continue to find violations of the current, lower levels of position limits that can be very profitable for violators. In January 2011, a Houston-based energy hedge fund managed by a former Enron trader was fined $15,000 by the New York Mercantile Exchange for exceeding natural gas position limits, the company's third violation of position limits in two years.[74] The hedge fund exceeded the

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[68] Proposed rule §151.4(d). 76 Fed. Reg. 4770.
[69] 76 Fed. Reg. 4770-4771; Government Accountability Office. *Issues Surrounding the Use of the Futures Markets to Invest in Commodity Indexes*. GAO-09-285R. January 30, 2009 at 31; CME Position Limit, Position Accountability and Reportable Level Table from CME Trading Qualifications and Practices Rulebook Chapter 5. Accessed March 2011; CFTC. Illustrative Tables for Position Limits Notice of Proposed Rulemaking. January 24, 2010.
[70] *Ibid*.
[71] 76 Fed. Reg. 4764.
[72] 76 Fed. Reg. 4762.
[73] 76 Fed. Reg. 4759.
[74] Loder, Asjylyn. "Centaurs Energy Master hedge fund fined for violating Nymex trade limits." *Bloomberg*. January 7, 2011.

contract limit by only 5.5 contracts, which earned over $4,000 in profits on a single day.[75] In 2009, a futures trader bought 4,495 long live cattle futures contracts -- exceeding the 450 speculative position limit by almost 10-fold -- from the beef cattle powerhouse JBS USA; the trader relinquished the $80,910 in profit and paid more than $140,000 as part of a settlement with the Commission.[76] In March 2011, the CME Group fined a hedge fund $50,000 for violating natural gas position limits for the third time in two years.[77] In February 2011, the CME Group fined a speculative trader $15,000 for violating the single-month position limit in soybean oil futures by more than 25 percent, the second time the firm violated position limits in two years.[78]

Agricultural Commodity Position Limits, Legacy Limits and Formula Limits

	Legacy Limit	Current Limit	Formula Limit[d]	Formula Limit Relative to Current Position Limits
CBOT Corn[a]	22,000	22,000	46,500	111%
CBOT Oats[a]	2,000	2,000	2,500	25%
CBOT Soybeans[a]	10,000	10,000	19,100	91%
CBOT Wheat[a]	6,500	6,500	16,200	149%
CBOT Soybean Oil[a]	6,500	6,500	10,800	66%
CBOT Soymeal[a]	6,500	6,500	7,500	15%
Minneapolis Hard Red Spring Wheat[a]	6,500	6,500	3,300	-49%
ICE U.S. Cotton No. 2[a]	5,000	5,000	9,500	90%
Kansas City Hard Winter Wheat[a]	6,500	6,500	6,700	3%
CME Feeder Cattle[b]	NA	1,500	3,000	100%
CME Lean Hogs[b]	NA	4,100	7,800	90%
CME Live Cattle[b]	NA	5,400	12,400	130%
Ice U.S. Coffee[b]	NA	5,000	6,800	36%
Ice U.S. Cocoa[b]	NA	6,000	5,500	-8%
Ice U.S. Sugar[b]	NA	10,000	25,600	156%
CME Rough Rice[c]	NA	1,800	2,500	39%
CME Class III Milk[c]	NA	1,500	3,000	100%

[a] 76 Fed. Reg. 4770-4771; [b] Government Accountability Office. *Issues Surrounding the Use of the Futures Markets to Invest in Commodity Indexes*. GAO-09-285R. January 30, 2009 at 31; [c] CME Position Limit, Position Accountability and Reportable Level Table from CME Trading Qualifications and Practices Rulebook Chapter 5. Accessed March 2011; [d] CFTC. Illustrative Tables for Position Limits Notice of Proposed Rulemaking. January 24, 2010.

The Commission should lower the formula for position limits significantly. The formula should be reduced to no higher than 5 percent of open interest. It may be reasonable to ensure liquidity for commodities with large volumes of futures contracts to raise position limits an additional 2.5 percent for open interest in excess of 25,000 contracts, or a 5/2.5 percent formula instead of a 10/2.5 percent formula. Moreover, combining the single-month and all-months combined position limit effectively increases the limit for single-month financial flows. The Commission should retain separate all-months combined and single-month position limits.

[75] *Ibid*.
[76] U.S. Commodities Futures Trading Commission. CFTC Docket No: 11-07. In the Matter of Newedge USA, LLC. February 7, 2011.
[77] Day, Matt. "CME fines hedge fund for natural-gas position limits." *Dow Jones*. March 15, 2011.
[78] Wilson, Jeff. "CME fines speculator $15,000 for violating position-limit rules." *Bloomberg*. February 4, 2011.

Position limits should also be applied to cleared and uncleared swaps contracts. The Commission is not establishing numerical position limits for single month or all-months combined swaps contracts until it gathers and analyzes data on the swaps market positions.[79] Given the high position limits established by the proposed rule, there is no reason not to apply position limits to swaps. Additionally, the Commission should have adopted position limits for commodity index funds and pools to prevent the excess speculation from these financial flows from distorting the commodities futures and derivatives markets. Position limits for swaps and index funds are necessary and would help ensure that the concentrated positions held by these market participants do not adversely distort the futures market.

Although this comment focuses on agricultural commodities, the same formula should be applied to energy and metals contracts, given the current level of volatility and financial flows into these markets in recent months. There is no reason to establish considerably higher position limits for energy and metals contracts than recommended for agricultural commodities.

Legacy Position Limits for Certain Agricultural Commodities §151.4(d)(3)

The Commission proposes exempting certain agricultural commodities from the proposed formula position limit.[80] The proposed rule provides legacy position limits for corn, oats, soybeans, soybean oil, soybean meal, wheat (on Chicago, Minneapolis and Kansas City exchanges) and cotton that maintain the current all-months combined position limits for these agricultural commodities.[81]

The legacy position limits are appropriate and should be expanded to include all agricultural commodities and soft agricultural commodity futures contracts and swaps. The proposed position limit formula would increase the position limit for agricultural commodities significantly. Absent the legacy position limit, the position limit for corn would more than double from 22,000 all-months combined contracts to 46,500 contracts.[82] The Chicago Board of Trade Wheat position limit would more than double from 6,500 contracts to 16,200 contracts; the soybean limit would nearly double from 10,000 to 19,100. The legacy position limits on these and certain other agricultural commodities will prevent a sudden expansion of speculation.

Many agricultural commodities are not protected by legacy position limits under the proposed rule. Feeder cattle, live cattle, class III milk, sugar, lean hogs, coffee and rough rice position limits would rise significantly under the proposed rule and these commodities are not covered by the proposed agricultural legacy position limits.[83] Many

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[79] 76 Fed. Reg. 4753.
[80] 76 Fed. Reg. 4760.
[81] Proposed rule §151.4(d)(3). 76 Fed. Reg. 4770-4771.
[82] CFTC. Position Limit Formula Spreadsheet. January 24, 2010.
[83] 76 Fed. Reg. 4770-4771; Government Accountability Office at 31; CME Position Limit, Position Accountability and Reportable Level Table from CME Trading Qualifications and Practices Rulebook Chapter 5; CFTC. Illustrative Tables for Position Limits Notice of Proposed Rulemaking.

of the agricultural commodities that are left unprotected by legacy position limits are vulnerable to excess speculation without strengthening the position limit levels.

The Commission must expand the legacy position limits to cover all agricultural commodities and soft agricultural commodities. Moreover, the Commission should reject the suggested legacy position limit recommendation by the Chicago Board of Trade that would increase the corn and soybean position limits by 50 percent, the wheat position limit by 85 percent, and the soybean oil position limit by 23 percent.[84]

Exemption to Position Limits for bona fide Hedging Transactions §151.5

The Commodity Exchange Act exempts *bona fide* hedgers from position limits designed to curb and prevent excess speculation. These end users are generally those companies, entities and producers that make or take delivery of the commodity. *Bona fide* hedgers include "producers, purchasers, sellers, middlemen, and users of a commodity or product derived therefrom to hedge their legitimate anticipated business needs."[85] The Dodd-Frank Act directs the Commission to define what constitutes a *bona fide* hedging transaction.[86]

Bona fide hedging exemptions to position limits should be limited to those end-users that make or take delivery of physical commodities and the transactions these parties use to manage their commercial risks on the futures and derivatives markets. The Dodd-Frank Act describes these end-users as those that own, produce, manufacture, process or merchandise commodities in the physical marketing channel or those that anticipate such activities.[87] The law further allows swaps transactions where a *bona fide* end user with such participation in the physical marketing channel to be exempt from position limits.[88]

The proposed rule would allow "all referenced contracts, including swaps" to be considered under the definition of *bona fide* hedging.[89] Swaps contracts that reduce risks for a *bona fide* hedging counterparty can be exempt from position limits under the proposed rules.[90] Many speculative contract and swaps positions have *bona fide* hedgers as their counterparties. This exemption needs to be extremely narrowly applied to ensure that it does not become an opening for large swaps traders and commodity index funds to swamp the market with excess speculation. During the past decade, the Commission approved no-action letters to some swaps funds to exceed agricultural position limits (see above), and although the Commission more recently rescinded these no-action letters, the exemption to the position limits rules for swaps used by legitimate end-users of commodities in the physical channel should be extraordinarily limited.

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[84] 76 Fed. Reg. 4760.
[85] 7 USC §6a(c).
[86] §737(c)(2). Dodd-Frank Act.
[87] §737(c)(2)(A)(i-iii). Dodd-Frank Act.
[88] §737(c)(2)(B).
[89] 76 Fed. Reg. 4760.
[90] Proposed rule §151.5(a)(iv). 76 Fed. Reg. 4771.

The Commission asks whether agents that are not responsible for merchandizing the physical commodity but are "linked" to its production, such as crop insurance agents, should be exempt from position limits.[91] Crop insurance agents should not be exempt from position limits for production that is underwritten by crop insurance policies they arrange.

Visibility Reporting Requirements Should be Extended to All Agricultural and Soft Agricultural Contracts §151.6

The proposed rule will establish visibility-reporting requirements for large traders "to make the physical and derivatives portfolios of the largest traders in referenced contracts visible to the Commission."[92] These visibility-reporting requirements would be set lower than position limits and would allow the Commission to monitor and evaluate the positions of large traders and the effectiveness of position limits. However, these useful visibility reporting requirements are only being applied to energy and metals contract positions and derivatives portfolios.[93] The proposed visibility levels for metals and energy contracts range from 18 percent of the non-spot month position formula for natural gas (21,000 contracts for visibility of 119,000 position limit under the formula) to three-quarters of the copper, silver and gasoline blendstock visibility levels (76, 75 and 74 percent of the formula position limits, respectively).[94] The Commission should also establish visibility levels for all agricultural and soft agricultural commodities that should be set no higher than 50 percent of the lower of either the legacy agricultural limit or the formula position limit.

Aggregate Position Limits §151.4 and Account Aggregation §151.7

The Dodd-Frank Act directs the Commission to apply position limits not just on each trading platform but across all platforms in order to ensure that the total positions on different designated contract markets, swap execution facilities and foreign boards of trade that provide direct access to U.S.-based traders.[95] The proposed rule applies position limits to designated contract markets, foreign boards of trade, and contracts that are price linked to designated contract markets or swap execution facilities.[96]

The proposed rule would also apply position limits to the aggregate positions any trader holds in multiple investment or trading vehicles.[97] The proposed rule applies position limits "to all positions in accounts in which any trader, directly or indirectly, has an ownership or equity interest of 10 percent or greater or […] controls trading."[98] Additionally, the proposed account position aggregation would require traders to

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[91] 76 Fed. Reg. 4761.
[92] 76 Fed. Reg. 4759.
[93] 76 Fed. Reg. 4761.
[94] Proposed rule §151.6(a). 76 Fed. Reg. 4773; CFTC. Illustrative Tables for Position Limits Notice of Proposed Rulemaking. January 24, 2011.
[95] §737(a)(4)(6). Dodd-Frank Act.
[96] 76 Fed. Reg. 4752.
[97] Proposed rule §151.7. 76 Fed. Reg. 4774.
[98] 76 Fed. Reg. 4762.

"aggregate positions in multiple accounts or pools, including passively managed index funds."[99] An investor with more than 10 percent interest in a pool and that has direct knowledge of trading positions or contributes to the day-to-day management of the pool's trading decisions would be aggregated into the trader's position limit.[100] All investors with more than 25 percent ownership stake in a commodity pool or index would be required to aggregate these positions.[101]

Aggregating position limits, especially for pools or index investors, is a much-needed improvement. According to the Government Accountability Office, average dealers held net-long positions in commodity index funds that exceeded single-month position limits for corn, soybeans, lean hogs and long cattle and exceeded both the single-month and all-months combined position limits for Chicago Board of Trade wheat, cotton and sugar.[102] The addition of commodity index investments into the futures markets was a significant contributing factor to the excess speculation and price volatility between 2006 and 2008. Ensuring that these financial flows are subject to position limits is essential to reducing excess speculation. The Commission should further ensure that position limits govern all index fund and commodity pool investments, not just aggregate the positions of certain traders in commodity index funds.

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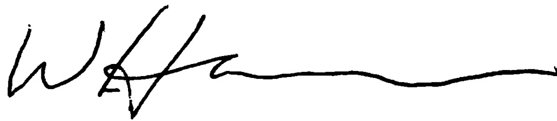
Food & Water Watch encourages the Commission to adhere to the Dodd-Frank Act directives and adopt strong position limits for all participants in commodity futures and derivatives markets. The proposed rule establishes position limits that are far too high and exempts many participants from application of the new position limits. The Commission should adopt strong position limits to govern not only the commodity futures trade but also commodity swaps trade, as directed by Dodd-Frank. Moreover, the Commission should exercise its authority to apply position limits to the commodity index funds that have significantly distorted the marketplace. Any exemptions from position limits should only be available to *bona fide* hedgers that are end-users of the physically traded commodity to ensure that these marketplaces maintain the necessary risk management functions for farmers and consumers around the world.

Sincerely,



Wenonah Hauter
Executive Director
Food & Water Watch

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[99] *Ibid*.
[100] Proposed rule §151.7(c). 76 Fed. Reg. 4774.
[101] §151.7.(c)(3).
[102] Government Accountability Office at 31.