

COMMODITY MARKETS OVERSIGHT COALITION

An Alliance of Commodity Derivatives End-Users and Consumers

August 31, 2011

David A. Stawick
Secretary, Commodity Futures Trading Commission
3 Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: “Position Limits for Derivatives,” 76 Fed. Reg. 4752 (January 26, 2011) RIN: 3038 (Supplemental Comments on Proposed Conditional-Spot-Month Limits)

Dear Mr. Stawick:

Members of the Commodity Markets Oversight Coalition (CMOC) are pleased to submit this letter to the Commodity Futures Trading Commission (“CFTC” or Commission”) on its Notice of Proposed Rulemaking RIN 3038-AD15 and RIN-AD16 regarding Position Limits for Commodity Derivatives.

I. Introduction

The Commodity Markets Oversight Coalition (CMOC) is an independent, non-partisan and non-profit alliance of groups that represent commodity-dependent industries, businesses and end-users such as airlines, farmers, petroleum marketers, gasoline station owners, home heating fuel businesses, and American consumers, who rely on commodity derivatives markets as a hedging and price discovery tool. The CMOC advocates for government policies that promote stability and confidence in the commodities markets, that seek to prevent fraud, manipulation and excessive speculation, and that preserve the interests of bona fide hedgers and consumers.

II. Conditional Spot-Month Speculative Limit Proposal

CMOC is very concerned about the Commission’s decision to create separate “conditional spot month position limits” for certain cash-settled contracts under Section 151.4(a)(2) that is five times the spot month limit (or 125 percent of deliverable supply) if the trader does not have a hedge exemption, if the positions are held exclusively in cash-settled contracts, and if the trader holds physical commodity positions that are less than or equal to 25 percent of deliverable supply. CMOC is also concerned that the conditional spot month limits could apply to passive investors (i.e., index funds) and therefore, used as an evasion of more stringent spot month limits. CMOC believes this is a major discrepancy regarding the proposed conditional-spot-month limit and the influence it could have on designated contract markets (DCMs) and exempt commercial markets (ECMs).

Given that the spot month is the period when the futures price converges with the underlying spot price as time approaches the contract's month of delivery, allowing five times leverage in the cash-settled "look alike" contract could be susceptible to arbitrageurs shorting or buying financially-settled contracts. This event could potentially disrupt the liquidation of the physically-settled futures contracts. Since the physically-settled contract and the linked cash-settled contract are economically equivalent, this could result in a traders' migration to the cash-settled contract rather than trading in the physically-settled contract which could potentially prevent hedgers from fulfilling the delivery of physical contract due to less liquidity in the physically-settled contract. The very definition of these contracts as "look-alikes" means what occurs in the financially-settled markets directly affects what occurs in the physical market.

In a letter to the CFTC dated August 17, 2011, Mr. Jeff Borchardt, President and CEO of the Kansas City Board of Trade, argues that there is "the potential for a speculator holding large positions in the financial contract (that settles to the price of the core contract) to influence the price of the core contract (to the benefit of the financial contract positions) by withholding a significant quantity of deliverable supply from the market when the core contract nearby month spread pricing indicates that physical delivery should occur to foster convergence. In fact, the speculator is prevented from participating in the physical delivery process, since their conditional financial position limit prohibits them from holding a position in the core contract spot month."¹ CMOC agrees with Mr. Borchardt's comments and respectfully requests that the Commission takes his letter into consideration.

Volatility and increased options costs will likely ensue if the financial-settled contract is able to enjoy five times leverage which could disrupt or unduly influence the price discovery function of the physical market leaving CMOC member companies very few options to hedge effectively. There is the possibility that options costs may exceed profit margins for many of CMOC member companies because higher conditional spot month limits may restrict the physical players' ability to compete for spot month speculative trading interests. Companies won't be able to hedge, whether in the petroleum, airline or agriculture business, and it will affect long-term planning for these companies.

In order to prevent a depletion of liquidity in the physical futures market and to uphold Dodd-Frank statutory requirements, CMOC urges the CFTC to treat the physically-settled contract and the cash-settled "look alike" contract the same. Given that most cash-settled contracts take place on unregulated exchanges granted through the Commission's "no-action letters," there's no need to treat physically-settled contracts and cash-settled "look

¹ See Kansas City Board of Trade Comment Letter on Position Limits dated August 17, 2011, available on the Commission's website

alike” contracts differently since they are economically equivalent. The ratio between the two contracts should essentially be one-to-one.

III. The CEA as amended by the Dodd-Frank Act requires Fair and Stringent Position Limits

Section 4a(3) of the Act, as amended by the Dodd-Frank Act, explicitly sets forth the factors that the Commission should apply in setting speculative position limits. The Dodd-Frank Act makes clear that the goals of speculative position limits are broader than restraining the market power of the very largest speculative traders. Section 4a(3), as amended by the Dodd-Frank Act, instructs that speculative position limits, to the maximum extent practicable, should achieve four goals:

- 1. diminish, eliminate or prevent excessive speculation;*
- 2. deter market manipulation;*
- 3. ensure liquidity for bona fide hedgers; and*
- 4. ensure that price discovery is not interrupted*

Importantly, Congress amended section 4a(3) of the Act to clearly state that deterring manipulation and diminishing excessive speculation are distinct goals of speculative position limits. In addition, Congress has required that speculative position limits be set to ensure liquidity for bona fide hedgers and to ensure the well-functioning of price discovery.

In conclusion, CMOC believes that the current proposed rule regarding the conditional-spot-month limit will undermine Dodd-Frank statutory requirements. The adoption of the current proposed rulemaking will increase the threat of price manipulation, especially in the final days of trading in the spot month of all commodity futures contracts which calls for physical delivery. The intent of Congress was not to allow regulatory arbitrage via position limits through favorable treatment of over-the-counter (OTC) exchanges at the expense of regulated DCMs. CMOC urges the Commission to take these comments into consideration before a final rule is implemented.

Respectively Submitted,

American Feed Industry Association
American Trucking Associations
Colorado & Wyoming Petroleum Marketers and Convenience Store Association
Colorado/Wyoming Petroleum Marketers Association
Florida Petroleum Marketers Association

Fuel Merchants Association of New Jersey
Gasoline & Automotive Service Dealers of America Inc.
Independent Connecticut Petroleum Association
Industrial Energy Consumers of America
Louisiana Oil Marketers & Convenience Store Association
Maine Energy Marketers Association
Massachusetts Oilheat Council
Montana Petroleum Marketers & Convenience Store Association
National Association of Oil & Energy Service Professionals
National Association of Truckstop Operators
New England Fuel Institute
New Mexico Petroleum Marketers Association
New York Oil Heating Association
New York Oil Heating Association
North Dakota Petroleum Marketers Association
Oil Heat Council of New Hampshire
Oil Heat Institute of Long Island
Oil Heat Institute of Rhode Island
Petroleum Marketers & Convenience Store Association Kansas
Petroleum Marketers & Convenience Stores of Iowa
Petroleum Marketers Association of America
R-CALF USA
The Organization for Competitive Markets
Vermont Fuel Dealers Association
West Virginia Oil Marketers and Grocers Association