



Trading | Numismatics | Refining | Close-outs | Depository

February 13, 2012

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

Re: Comments of Dillon Gage Group to the Interpretation Regarding Retail Commodity Transactions Under the Commodity Exchange Act (RIN 3038-AD64)

Dear Mr. Stawick:

On December 14, 2011, the Commodity Futures Trading Commission (the "CFTC") published in the Federal Register¹ an interpretation of the statutory language "actual delivery" (the "Interpretation") as set forth in section 2(c)(2)(D)(ii)(III)(aa) of the Commodity Exchange Act (the "CEA") pursuant to Section 742(a) of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). The CFTC has requested comments as to whether the Interpretation accurately construes the statutory language.

The Dillon Gage Group ("Dillon Gage") was founded in 1976 and today includes five companies offering a variety of financial services from securities and financial planning to a robust commodities group offering a range of services, including buying, selling and storage. Specifically, the five companies are:

- Dillon Gage Securities – A full-service FINRA and SIPC member firm that specializes in financial planning.
- Dillon Gage Inc. of Dallas – One of the largest precious metals dealers in the United States.
- Dillon Gage Incorporated – A company dealing in the futures markets and a member of the National Futures Association.
- International Depository Services of Canada – a depository company located in Mississauga, Ontario, Canada.
- Diamond State Depository - A wholly-owned, independently-operated precious metals storage facility located in New Castle, Delaware.

¹ FR Vol. 76, No. 240, pages 77670-77672.

Diamond State Depository offers independent facilities, systems, staff, security and insurance to its clients, both institutional and individual investors, to ensure their investments in precious metals bullion and certified coin markets are securely stored and insured.

Dillon Gage appreciates the efforts made by the CFTC and Congress to curtail any fraudulent retail commodity transactions occurring by unscrupulous actors. We also understand the intent of the Retail Commodities Transactions provision² (the "Retail Commodities Transactions Provision") to bring a portion of the off-exchange market onto regulated exchanges to prevent fraud. However, we are concerned that the Interpretation extends beyond the legislative intent of the Retail Commodities Transactions Provision and may have unintended consequences that may increase costs and decrease the market's efficiency.

Therefore, Dillon Gage respectfully submits the following recommendations and comments in response to the Interpretation, seeking further clarifications and modifications to the Interpretation.

I. Storage of Commodity at Seller's Affiliate

Example 2 of the Interpretation provides that for "actual delivery" to occur the commodity must be stored at certain depositories and, in addition, such depositories may not be the seller or its parent company, partners, agents, or other affiliates of the seller.³ Such exclusionary language is overly broad as it goes beyond the intent of the Retail Commodities Transactions Provision. As stated by Senator Lincoln, the intent of the statutory language was to curtail "instances of fraudsters" who were promising fraudulent returns on commodity investments and were using rolling spot contracts "in order to evade the CFTC's jurisdiction over futures contracts."⁴ While we understand the CFTC's desire to ensure, among other things, that the seller actually has the commodity to deliver, an affiliate of one of the limited types of depositories described in Example 2 are unlikely to be the seller "fraudsters" Senator Lincoln had in mind. Rather, such seller and its affiliates are likely to be regulated entities often possessing a significant net worth and subject to robust reporting requirements (e.g., trading divisions of Financial Institutions and trading companies registered with the CFTC, National Futures Association or a commodities exchange).

Further, from a commercial perspective, offering a seller associated storage facility to a purchaser is not an uncommon commercial arrangement since it allows the seller to offer its customers some economies of scale (*i.e.*, the one-stop-shop arrangement). The seller-to-seller's-affiliate delivery provides certain market efficiencies and synergies benefiting both buyers and sellers by lowering transaction costs and risks. For example, delivery by the seller to

² 7 U.S.C. 2(c)(2)(D).

³ 76 Fed. Reg at 77672. Under Example 2, for "actual delivery" to occur the commodity must be stored at (a) certain financial institutions, (b) depositories whose warrants or warehouse receipts are recognized for delivery purposes for any commodity on a contract market designated by the CFTC or (c) storage facilities licensed or regulated by the United States or any United States agency.

⁴ 15 Cong. Rec. S 5924 (daily ed. July 15, 2010) (statement of Sen. Lincoln).

an affiliate of the seller helps limit transportation costs and risks such as loss or damage to the commodity. By disallowing a seller's affiliate to take delivery, market participants in the metals industry may experience increased costs such as:

- 1) Increased transportation costs associated with the safe, secure and timely shipment of precious metals and coins.
- 2) Increased insurance costs for shipping precious metals and coins.
- 3) Loss of business revenues generated from storage fees of precious metals and coins and directing clients to competitors.

Depositories, such as Diamond State Depository, hold assets for multiple clients, so often transactions between parties require only internal storage location changes or simple book entry title transfers. Should Diamond State Depository need to ship metal from its facility to another depository to satisfy new CFTC requirements, the customer will need to pay the additional expenses such as handling charges, armored car transportation expenses, and establish a new account at the new facility. Collectively, these additional payments will account for millions of dollars annually in new costs borne by the customers of Diamond State Depository. A further cost to the customer, though difficult to quantify, is that such transfers between facilities can delay a customer's access to their metal for as much as five days, which has opportunity costs. Lastly, metal in transit presents a higher security risk.

The above costs may not be significant in the context of large transactions where either large quantities of precious metals are purchased or numerous transactions occur over which these costs can be spread out, but transactions seeking an exemption pursuant to CEA § 2(c)(2)(D)(ii)(III)(aa) involve non-eligible contract participants. The ability to spread out costs and other economies of scale associated with high volume transactions are much more limited. Instead, these costs are often absorbed by seller to the extent possible, and then passed on to the customer. Were the limitation on appropriate depositories to exclude only seller's depositories, then many of these costs could not only be reduced but still remaining costs could more easily be absorbed through services offered in conjunction with the storage of purchased metals.

The Interpretation fails to address the potential cost increases and market disruptions associated with potentially decreasing the number of market participants, transactions and overall liquidity. We believe a discussion of these costs within a cost-benefit analysis is necessary to adequately address whether the CFTC accurately construed the statutory language. As discussed above, given the safeguards the CFTC has devised by limiting depositories and storage facilities that may take "actual delivery" to those which already face regulatory and reporting requirements, we do not believe any additional benefit is gained by requiring affiliate sellers of such depositories to direct delivery to a non-affiliate-depository subject to the same or similar regulations as the seller-affiliate-depository. Further, any such benefit is more than offset by increased costs to retail commodity customers.

We also note that the Model State Commodity Code does not expand the notion of depositories which do not constitute "actual delivery" to include affiliates of the seller. Under the Model State Commodity Code, only the seller was prohibited from taking delivery. We note that the CFTC states in the Interpretation that an agreement, contract, or transaction that results in "physical delivery" within the meaning of the Model State Commodity Code "would ordinarily result in 'actual delivery'...absent other evidence indicating that the purported delivery is a sham." Thus, Example 2's interpretation results in a situation where a *bona fide* transaction resulting in "physical delivery" under the Model State Commodity Code would not be an "actual delivery" under the CEA. While the Model State Commodity Code is not a determining factor for the occurrence of actual delivery, it more accurately reflects market realities relating to storage facilities and depositories than the current Interpretation. In addition to the above issues, the Interpretation will often result in the delivery of metals to a seller's competitor due to the limited number of depositories and storage facilities in the market. Dillon Gage is only aware of 12-15 depositories or storage facilities offering private vaulting or warehousing services similar to Diamond State Depository. Depositories and storage facilities similar to Diamond State Depository help to facilitate the market, providing liquidity and settlement services to not only investors but other financial institutions, and although the Interpretation does provide for actual delivery to be made to certain financial institutions, the Dillon Gage Group is only aware of three to five banks actively engaged in providing the appropriate services for investors in this market, further emphasizing the limited scope of players in the market. The Model State Commodity Code reflects such realities by not including a seller-affiliate limitation.

Based on the foregoing, we believe that the phrase "other than the seller and its parent company, partners, agents, and other affiliates" set forth in Example 2 should be revised to read "other than the seller" so as to more accurately reflect the intent of the statutory language "actual delivery."

II. Proposal: Fourth Type of Appropriate Depository

We also believe that the list of appropriate depositories set forth in Example 2 of the Interpretation should be expanded to include a fourth type of depository or storage facility which not only ensures that the list of acceptable depositories accounts for current market practice, but continues to ensure that only those depositories and storage facilities are included which are unlikely to be involved with unscrupulous and fraudulent actors. The fourth type of storage facility and depository (hereinafter, an "Independent Distribution Depository") is described as:

"a depository or storage facility which (i) regularly engages in the business of holding bullion, coins, and precious metals, (ii) is widely recognized within the industry for providing such services as a business activity, (iii) holds the coins, bullion or precious metals off its balance sheet in the name of the account beneficiary, (iv) carries sufficient risk insurance to cover losses in the event of theft, destruction, or other loss, equal to or greater than the value of the bullion, coins and precious metals held, but in no case less than \$100 million of coverage, provided by insurers having a rating of "A" or higher from an

independent nationally recognized credit rating organization, and (v) issues, and the purchaser receives, a certificate, document of title, confirmation or other instrument evidencing that such quantity of precious metals has been delivered to the depository or storage facility and is being and will continue to be held by the depository or storage facility on the purchaser's behalf, free and clear of all liens and encumbrances, other than liens of the purchaser, tax liens, liens agreed to by the purchaser, or liens of the depository for fees and expenses, which have previously been disclosed to the purchaser."⁵

Such Independent Depositories are widely recognized as providing fully insured reliable storage. Further, such depositories arguably provide more protection for customers than some financial institutions. For example, metals kept in a safe deposit box at the local branch of a financial institution are not insured by the FDIC, while the same assets kept at an Independent Distribution Depository are insured for losses by creditworthy insurance companies. Another benefit of storing metals at an Independent Distribution Depository is the fact that a purchaser's assets are held off-balance as bailments, not deposits or consignments (*i.e.*, not commingled with the Independent Distribution Depository's own assets), and are subject to definitive custody account agreements executed by depository customers. Customers of Independent Depositories control their metals, as such assets are all titled in the name of individual clients, providing the client complete control of the metals such that the Independent Distribution Depository cannot pledge, transfer, relocate, or otherwise dispose of their customers' metals without the express written instructions of their customers. Customers also receive additional comfort and security knowing that their deposits are appropriately accounted for due to regular annual audits of the assets held by the Independent Distribution Depository. With Diamond State Depository, its corporate customers have the legal right to perform an audit on its accounts with one day's notice to allow the appropriate security checks, and individual customers can request delivery of their metals at any time.

Based on the foregoing, we believe that Congress did not intend to limit delivery to Independent Depositories. Rather, the focus should be on ensuring that the Independent Distribution Depository is financially sound.

Dillon Gage appreciates the opportunity to provide comments on the Interpretation. Dillon Gage recommends that the CFTC remove the seller-to-seller's-affiliate limitation on affecting "actual delivery" as well as consider adding a fourth category of depositories and storage facilities as described above or, in the alternative, provide further explanation as to the intent and perceived benefits of such limitation so that market participants may more adequately

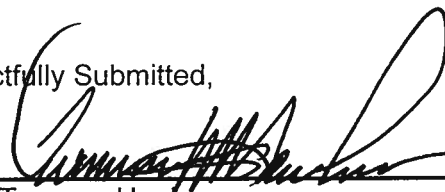
⁵ We have drafted this fourth type of depository to address depositories or storage facilities in the metals and coins industry since that is our business sector. Presumably, a similar definition could be used for other commodities. Further, we believe that an affiliate of an Independent Distribution Depository would be similar to a seller-affiliate of depositories listed in Example 2 of the Interpretation, and, thus allowing a seller to make delivery to its affiliate Independent Distribution Depository would create no greater risk that if such seller had to deliver to a third-party depository.

address whether the CFTC's interpretation accurately construes the statutory language and the intent of its drafters.

Dillon Gage hopes the CFTC finds these comments constructive and will provide commenters a second opportunity to comment on any changes to the Interpretation.

If you have any questions regarding the above comments and recommendations, please contact me directly at telephone numbers 972-386-2901 or 1-800-375-4653.

Respectfully Submitted,

A handwritten signature in black ink, appearing to read 'Terence Hanlon', written over a horizontal line.

Name: Terence Hanlon

Title: President of Dillon Gage Metals

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