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Ms Melissa Jurgens
Secretary
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, NW
Washington, DC 20581
USA

6 February 2014

Dear Ms Jurgens

Re: Position Limits for Derivatives; Proposed Rule (RIN 3038-AD99)

The World Gold Council respectfully submits to the Commodity Futures Trading Commission ("CFTC" or "Commission") the following comments and recommendations in response to the Federal Register Notice of December 12, 2013[1] that pertains to the notice of proposed rulemaking to establish position limits for certain physical commodity derivatives (the "Proposed Rule") pursuant to Section 737 of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").

The World Gold Council is the market development organization for the gold industry. Working within the investment, jewelry and technology sectors, as well as engaging in government affairs, the purpose of the World Gold Council is to provide industry leadership, while stimulating and sustaining demand for gold.

Established in 1987, the World Gold Council is a leading authority on the international gold markets, helping people to better understand the wealth preservation qualities of gold and its role in meeting the social, economic, and environmental needs of society. In this capacity, the World Gold Council has a strong interest in fair, transparent and orderly markets and supports measures that would reduce potential for market distortions.

The World Gold Council fully supports the CFTC's efforts to reduce systematic risk in the market for commodity futures and their derivatives in keeping with the principles of the Dodd-Frank Act. However, the approach that the CFTC has proposed takes a "one-size-fits-all" approach, which we believe could unintentionally harm participants in gold markets and might even lead to the opposite results of those intended by the CFTC, as the gold market is significantly different from other commodity markets. Furthermore, position limits are not a panacea for controlling excessive speculation. Prior to implementing position limits, the CFTC should consider the efficacy of position limits compared to other tools that police excessive speculation such as limits on the usage of leverage or intraday position monitoring. The CFTC should also consider the impact that changes to the regulatory framework may have on trading activity on markets that are not regulated by the CFTC, especially in markets as large as gold.

[1] U.S. CFTC, Position Limits for Derivatives, 78 Fed. Reg. 75,680 (Dec. 12, 2013). This notice reissues position limits because the previous rule was vacated. *Int'l Swaps & Derivatives Ass'n v. U.S. CFTC*, 887 F. Supp. 2d 259 (D.D.C. 2012); *see* U.S. CFTC, Position Limits for Futures and Swaps, 76 Fed. Reg. 71,626 (Nov. 18, 2011) ("Vacated Rule"). The World Gold Council submitted comments in response to the previous Notice of Proposed Rulemaking, published on January 26, 2011. *See* U.S. CFTC, Position Limits for Derivatives, 76 Fed. Reg. 4,752 (Jan. 26, 2011).

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1. **The Proposed Rule's analysis of gold is insufficient.**

   The Proposed Rule does not consider whether position limits are necessary on a commodity-by-commodity basis, instead making a general case that the proposed position limits may reduce excess speculation. The decision not to analyze the suitability of position limits to each market leads to uninformed decision-making with respect to the impact of the position limits on each market and could lead to unintended consequences.

   With respect to the gold market, the Proposed Rule's examination of the available studies relevant to this decision is incomplete and insufficient. The Proposed Rule limits its detailed discussion to two studies that the CFTC interprets to support position limits, a study of the 1979-80 silver market price oscillation and the 2006 natural gas price volatility.[2] However, the Proposed Rule does not provide any quantitative analysis of how the outcome of these events might have differed if the proposed position limits had been in place. The Proposed Rule does not provide analysis of how the proposed position limits would curb excess speculation in the gold market. Further, none of the 132 studies listed in Appendix A to the preamble that the CFTC reviewed in formulating the Proposed Rule take into consideration the unique characteristics of the global gold market.[3]

   The Proposed Rule requests that commenters submit any additional studies that the CFTC should consider. The World Gold Council respectfully requests that the CFTC allow the World Gold Council and other members of the gold market community, which may include the applicable exchanges, more time to conduct additional studies that specifically address position limits within the gold market and allow, in the meantime, for the relevant exchanges to regulate their position limits as they currently do.

   The CFTC should base the decision to establish position limits on an individual analysis of the market for each underlying commodity. It is impossible to assess the appropriateness or appropriate level of position limits for a commodity such as gold on the basis of studies of the natural gas and silver markets. While there may be similarity among some subsets of commodities, the gold market is unique. Compared to other commodities, gold is highly liquid, is not consumed, and traded on a much larger global scale.[4] An individual determination for each underlying commodity will ensure that needed position limits are set to an appropriate level and prevent the establishment of unnecessary or unhelpful position limits, resulting in more effective regulation.

2. **Federal position limits could lead to an increase in existing exchange position limits in practice.**

   The World Gold Council is concerned that the CFTC's promulgation of position limits covering gold contracts may result in an increase in the exchange-promulgated limits. For example, the CME Group, Inc. ("CME") has set a spot-month position limit of 3,000 contracts for gold futures. The Proposed Rule sets forth one alternative that establishes a federal spot-month position limit up to 27,300 contracts.[5] The update procedure in the Proposed Rule relies solely on one quarter of the estimated deliverable supply. The establishment of a federal limit well above the current exchange limit could encourage the exchanges to raise their limits to match the federal limit, creating a "race to the bottom" within the current regulatory regime. Because the proposed federal limits do not take into

[2] *Id.* at 75,691
[3] *Id.* at 75,784-87.
[4] Further discussion of the characteristics of the world gold market is included in the Appendix.
[5] 78 Fed. Reg. at 75,727-28 (Table 9).

account the unique characteristics of each commodity, the establishment of federal limits according to a generic formula may limit the effectiveness of the exchange's self-regulation. Further, the alternative limit on spot-month contracts is also well above the non-spot-month single-month and all-months-combined position limit of 21,500 contracts, which was calculated using the proposed 10, 2.5 percent formula.[6]

The setting of speculative position limits for derivatives is a task best-suited to the exchanges on which the commodity futures are traded with oversight by the CTFC. The CFTC has historically recognized that the exchanges are best suited to this task and has delegated the authority to establish futures position limits to the exchanges so that "the exchanges would have an opportunity to employ their knowledge of their individual contract markets to propose the position limits they believe most appropriate."[7] The introduction of "one-size-fits-all" federal position limits for derivatives could supplant the historic role of the exchanges, undermining the effectiveness of the position limit regime by creating an incentive for the exchanges to set their position limits equal to the federal limit, which has not taken into account the unique nature of the commodity or the exchange. This outcome may increase the position sizes among speculators and undermine the goal of the Dodd-Frank Act amendments to the CEA.

Accordingly, the World Gold Council requests that the CFTC withdraw the Proposed Rule as it relates to the gold market until after the CFTC is able to determine the appropriateness and appropriate level of position limits for gold. However, if the CFTC determines to issue final position limit rules with respect to gold contracts, the World Gold Council requests that the CFTC consider the comments listed below in connection with final position limit rules impacting the gold markets.

3. **The spot-month position limits should account for the inherent differences between commodities.**

The Proposed Rule does not undertake an analysis of the appropriate level for the position limits for individual commodities. In particular, the World Gold Council is concerned about the Proposed Rule's procedures for setting spot-month position limits. The Proposed Rule requests comments on three alternatives for the establishment of spot-month position limits.[8] Of these alternatives, the World Gold Council believes that using Designated Contract Market-established levels is the best approach because this approach defers to the established exchange limits that take into account the unique nature of each commodity.

The use of the "one quarter of the estimated deliverable supply" as a basis for the upper spot-month limit is not appropriate for the gold market. For this alternative, the Proposed Rule justifies its selection of one quarter of the estimated deliverable supply because "based on the Commission's surveillance and enforcement experience, this formula narrowly targets the trading that may be most susceptible to, or likely to facilitate, price disruptions."[9] However, this approach does not provide a full reflection of the gold market. The exchange-set spot-month limit was 3,000 contracts. The CME estimated deliverable supply at 109,111 contracts. Therefore, one quarter of the estimated deliverable supply (rounded to the nearest 100 contracts) equates to 27,300 contracts. The exchange-set limit of 3,000 contracts is equivalent to 2.7% of the estimated deliverable supply. The CFTC's proposed formula would result in a position limit that is more than nine times the current exchange-set limit and it exceeds the proposed limit on non-spot and all months.

[6] *Id.* at 75,729-31 & 76,787 (corrected Table 10).
[7] U.S. CFTC, Establishment of Speculative Position Limits, 46 Fed. Reg. 50,938, 50,940 (Oct. 16, 1981).
[8] 78 Fed. Reg. at 75,727-29.
[9] *Id.* at 75,729.

Setting such a limit for positions in gold future derivatives ignores the realities of the gold market.

In the gold market, the most active month does not always coincide with the spot month or current delivery month. The proposed position limits could distort trading on gold futures when investors focus their open interest in the active, but non-current month, or roll their positions from the spot month contract to the next available contract. Frequently, gold contracts for February, April, June, August, October, and December delivery exceed volumes and open interest levels for other months. This characteristic of the gold market highlights the importance of analyzing the market for each commodity individually prior to imposing position limits.

For the same reasons, the World Gold Council is concerned about the spot-month limit update procedure contained in Proposed Rule § 150.2(e)(3). The proposed biennial updates to the position limit states that the limit shall be updated to "no greater than one-quarter of the estimated spot-month deliverable supply."[10] However, other than providing this maximum, neither the preamble nor the proposed regulations provide any guidance on how CFTC will set the limits. Rather, the CFTC "observes that there may be a range of spot month limits, including limits set at levels below 25 percent of deliverable supply, which may serve as practicable to maximize these policy objectives" and that the exchanges have imposed more stringent position limits.[11] If the CFTC establishes speculative position limits, it should do so in a manner that accounts for the unique nature of each commodity, rather than rely on a formulaic approach in the Proposed Rule.

4. The expansion of the conditional spot-month limit exemption is unwarranted.

The Proposed Rule's expansion of the conditional spot-month limit exemption is not supported by sufficient research and could negatively impact the gold market. Specifically, allowing positions of five times the spot-month limit for traders carrying exclusively cash-settled positions may decouple the market for cash-settled contracts from physically-settled contracts. The physical delivery contract is the tie between the futures market and the cash market. Regulations should not create disincentives for participation in the physical contract in favor of the cash settled contract because such a step is likely to lead to lower liquidity in physical contracts and consequently higher volatility. This may also call into question the utility of the market for price discovery. As discussed above, the Proposed Rule's method for establishing spot-month limits will lead to a limit that is well above the current limits set by the exchanges for gold, which could ultimately result in increased position limits from the current exchange-set level.

Furthermore, the Proposed Rule cites no research on the impact of this rule on the market for gold or other precious metals. Rather, the Proposed Rule states that the CFTC "has examined market data on the effectiveness of conditional spot-month limits for cash-settled *energy* futures swaps…"[12] The Proposed Rule does not analyze the spot-month market for gold or other precious metals. Nonetheless, the CFTC "preliminarily believes" that this exemption will not adversely affect the price discovery function of the physical market.[13] Our experience in the gold market leads us to disagree with the CFTC's belief. This difference in position limits will lead to regulatory arbitrage, driving liquidity from physical delivery contracts to cash-settled contracts and decoupling the trading of cash-settled contracts from the physical market. This approach will likely undermine the price discovery function of the physical market and limit the ability of market participants with physical holdings to hedge effectively.

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[10] *Id.* at 75,827, Proposed § 150.2(e)(3).
[11] *Id.* at 75,729.
[12] *Id.* at 75,736-37 (emphasis added).
[13] *Id.*

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The CFTC should limit the conditional spot-month exemption to those markets for which its analysis shows that the exemption will not be detrimental to the market.

5. **The CFTC should use a consistent approach to setting spot-month and non-spot-month limits.**

   The CFTC should set the non-spot-month limits on the basis of consistent set of data relative to the spot-month limit. The Proposed Rule states that the CFTC will set the initial non-spot-month position limits based on "open interest for calendar years 2011 and 2012 in futures contracts, options thereon, and in swaps that are significant price discovery contracts that are traded on exempt commercial markets."[14] For gold, this calculation results in a lower limit (21,500 contracts) than the upper limit proposed for the spot-month based on 25% of deliverable supply (27,300 contracts) and will likely create confusion in the market. The CFTC should undertake research to determine which methodology – deliverable supply or open interest – is best suited to setting position limits, and then apply a consistent methodology to both spot and non-spot months.

If you have any questions regarding the above comments and recommendations, please contact me directly on aram.shishmanian@gold.org.

Yours sincerely

Aram Shishmanian
Chief Executive Officer

[14] *Id.* at 75,730.

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Appendix: Gold is fundamentally different from other commodities.

The World Gold Council submits that gold is fundamentally different from the other commodities referenced in the Proposed Rule.

Unlike agricultural and energy commodities, gold is not consumed in a normal sense as virtually all of the gold that has ever been mined still exists. It is estimated that there are more than 172,000 tonnes of gold in above ground stock. The vast majority of gold remains in the hands of the general public in the form of jewelry, bars and coins, but a large portion is held and used by central banks and governments, financial institutions and other commercial institutions. This contrasts significantly with the other commodities potentially subject to position limits, which can be more finite in supply and can spoil or be spent in normal consumption behavior. The existence of large and liquid above ground stocks means the supply of gold to the market does not suffer similar pressures as other commodity markets.

Gold mine production is derived from numerous separate operations on all continents of the world (other than Antarctica) making it a truly global commodity with limited supply concentration risks in contrast to many other commodities. For example, no single region produces more than 20% of global mine supply. Therefore, any disruption to production in any one locality is unlikely to affect a significant number of these operations simultaneously. Furthermore, the rapid mobilization of above ground gold stocks from fabricated sources like jewelry can help to support any supply shortages by its re-entry into the market through recycling of gold.

The financial market in gold is large, deep, and among the most liquid of financial assets. Gold trades in an around the clock global market in exchanges and over-the-counter, serving both as a monetary asset as a quasi currency, and as a financial asset as a form of investment. Gold has been used in this manner since as early as 500 BC when the first gold coin was struck. For hundreds of years gold served an important official role in the global monetary system when many countries backed their currencies with gold. While gold no longer has a legal role in the world's monetary system, central banks and governments continue to hold 17.5 percent of all above ground stocks of gold and hold it as one of their largest reserve assets in order to preserve the wealth of society and protect against macroeconomic and financial shocks.