February 10, 2014

Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
Washington, DC 20581
RIN No. 3038-AD99

VIA AGENCY WEBSITE: http://comments.cftc.gov

Re: CFTC Position Limits for Derivatives (78 Fed. Reg. 75,680) (the "**Proposed Rule**")

Dear Sir or Madam:

The Committee on Capital Markets Regulation (the "**Committee**") is grateful for the opportunity to comment on the Proposed Rule,[1] issued by the Commodity Futures Trading Commission (the "**CFTC**") pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Dodd-Frank Act**").

Founded in 2006, the Committee is dedicated to enhancing the competitiveness of U.S. capital markets and ensuring the stability of the U.S. financial system. Our membership includes thirty-three leaders drawn from the finance, investment, business, law, accounting, and academic communities. The Committee is chaired jointly by R. Glenn Hubbard (Dean, Columbia Business School) and John L. Thornton (Chairman, The Brookings Institution) and directed by Hal S. Scott (Nomura Professor and Director of the Program on International Financial Systems, Harvard Law School). The Committee is an independent and nonpartisan 501(c)(3) research organization, financed by contributions from individuals, foundations, and corporations.

Executive Summary

The Proposed Rule would apply position limits on an aggregate basis to derivative contracts based on a common underlying commodity.[2] It would set a cap on the maximum number of derivatives contracts that an individual trader may purchase or sell during a given period based on a maximum market share of estimated deliverable supply of the relevant commodity or the open interest on derivative contracts.[3] Producers or consumers of commodities seeking to hedge their exposure to price fluctuations would be exempt from the Proposed Rule.[4]

The Committee has several concerns with the Proposed Rule. First, the proposed position limits are based on incomplete data, are inappropriately calibrated, and have not been subject to any meaningful cost-benefit analysis. Second, the CFTC has failed to establish that the Dodd-Frank Act empowers it to impose position limits without first conducting a necessity determination. Finally, the CFTC has also failed to establish that position limits are necessary to address excessive speculation in commodity derivatives markets.

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[1] Position Limits for Derivatives, 78 Fed. Reg. 75,680 (proposed Dec. 12, 2013).
[2] *Id.* at 75,681.
[3] *Id.* at 75,826-75,827.
[4] *Id.* at 75,827-75,828

We urge the CFTC to determine first whether excessive speculation is causing unreasonable price fluctuations in commodity markets and, if so, whether position limits would reduce such fluctuations. If the CFTC determines that position limits are necessary and effective, then the CFTC should calibrate position limits appropriately so as not to reduce liquidity for hedgers or impede the price discovery process.

Position Limit Calibration

The Dodd-Frank Act authorized the CFTC to establish aggregate position limits for speculative traders in commodity derivatives in order to address excessive speculation and market manipulation that could cause unwarranted price fluctuations, thereby increasing costs for producers and consumers.[5] However, due to the critical role that speculators play as liquidity providers, the Dodd-Frank Act requires that these position limits not be so restrictive that they impede the price discovery function of the derivatives markets and further requires that the CFTC ensure that sufficient market liquidity continues to exist for hedgers.[6] Indeed, the Dodd-Frank Act requires that the CFTC balance these competing concerns "to the maximum extent practicable."[7]

It is, of course, the calibration of these position limits and their restrictiveness that will determine whether excessive speculation has been addressed "to the maximum extent practicable" and whether market liquidity and price discovery have been disproportionately affected. The Proposed Rule fails to set certain of its position limits in a manner that balances these competing concerns to the "maximum extent practicable," as the CFTC engages in no reasoned analysis as to why certain of its position limits are appropriate. The Proposed Rule does not consider, for example, whether a 10% limit on market share during non-spot months is more or less effective at achieving the statutory requirements than a higher or lower position limit. The Proposed Rule contains no quantitative cost-benefit analysis as to the calibration of position limits. Indeed, the CFTC concedes that data regarding the open interest of certain commodity derivative markets are incomplete at best.[8]

CFTC Interpretation of the Dodd-Frank Act

We disagree with the CFTC's view that the agency may impose position limits without first determining that such limits are necessary to reduce excessive speculation. On September 28, 2012, the U.S. District Court for the District of Columbia (the "**D.C. Circuit**") vacated and remanded[9] the CFTC's initial position limit rule on grounds that the agency had erroneously concluded that the Dodd-Frank Act "unambiguously" required the CFTC to impose position limits without first determining that position limits were necessary to address excessive speculation.[10] Having concluded that the Commodity Exchange Act (the "**CEA**"), as modified by the Dodd-Frank Act, was ambiguous, the court reasoned that it could not rely on the CFTC's rulemaking to resolve the ambiguity, as the D.C. Circuit has previously held that "deference to an agency's interpretation of a statute is not appropriate when the agency wrongly believes that

[5] 7 U.S.C. § 6a (2012).
[6] 7 U.S.C. § 6a(3) (2012).
[7] *Id.*
[8] Position Limits for Derivatives, 78 Fed. Reg. 75,680, 75,690 (proposed Dec. 12, 2013).
[9] *International Swaps and Derivatives Association v. United States Commodity Futures Trading Commission,* 887 F. Supp. 2d 259 (D.D.C. 2012).
[10] *Id*. At 13.

interpretation is compelled by Congress."[11] The court thus vacated the rule and remanded the matter to the CFTC to use its "experience and expertise" to resolve the ambiguities in the statute, instructing the CFTC that "it is incumbent upon the agency not to rest simply on its parsing of the statutory language."[12] On remand, the CFTC has determined that the Dodd-Frank Act does not require it to determine that position limits are necessary prior to issuing the Proposed Rule.[13]

First, the CFTC concludes that the existence of two congressional studies, respectively finding that excessive speculation led to fluctuations in crude oil prices in 2006 and natural gas prices in 2007,[14] strongly suggests that Congress had determined that position limits were necessary for commodity derivative markets generally and would not have wanted the CFTC to conduct a "duplicative" assessment as to whether position limits are necessary.[15] However, the studies to which the CFTC refers do not reach any conclusions regarding excessive speculation in commodity derivative markets generally nor do they conclude that position limits are necessary to address such speculation. Instead the studies recommend that additional transparency in commodity derivatives markets would be the most effective way to prevent such events from recurring. Indeed, the comprehensive reporting regime required by the Dodd-Frank Act directly addresses these recommendations. Therefore, these studies in no way bear upon the question of whether Congress desired the CFTC to determine that position limits are necessary in advance of promulgating the Proposed Rule.

Second, the CFTC posits that because the Dodd-Frank Act includes six and nine month deadlines for imposing position limits, Congress could not have wanted the CFTC to determine that position limits are necessary before setting position limits, because in the past comparable determinations took a few months longer than the time allotted by the Act.[16] The CFTC specifically refers to position limits imposed by the CFTC's predecessor agency in the 1930s.[17] The agency's arguments here strain credulity. The relevance of the eight-decades old position limits of an extinct agency to the procedural requirements of the Dodd-Frank Act is tenuous at best. Moreover, the CFTC's position is further belied by the fact that it and other agencies charged with implementing the Dodd-Frank Act have regularly missed statutory rulemaking deadlines in order to ensure that rulemakings are based on a reasoned analysis.

Third, the Dodd-Frank Act requires the CFTC to conduct a study of the effects of any position limits imposed within one year of implementation, followed by congressional hearings.[18] The CFTC reasons that Congress would not have wanted the agency to conduct studies in order to determine whether a limit was necessary, because this would impose unnecessarily burdensome and duplicative requirements. The agency thus conflates (i) an *ex ante* study undertaken to determine whether position limits are necessary at all with (ii) an *ex post* review to determine retrospectively whether the adopted limits have been effective.

Indeed, the Committee is not aware of any instance where the CFTC imposed position limits on commodity derivatives without first making a necessity finding.

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[11] *Id.* at 36-38.
[12] *Id.* at 38.
[13] Position Limits for Derivatives, 78 Fed. Reg. 75,680, 75,681-75,682 (proposed Dec. 12, 2013).
[14] *Id.* at 75,682.
[15] *Id.* at 75,684.
[16] *Id.* at 75,682-75,683.
[17] *Id.* at 75,683.
[18] 15 U.S.C. § 8307 (2012).

Necessity of Position Limits

In the alternative, the CFTC also contends—"as a separate and independent basis" for the Proposed Rule—that position limits are necessary to reduce excessive speculation.[19]

The CFTC concludes that position limits are necessary to reduce excessive speculation, because they would have prevented two specific instances of illegal manipulative trading in commodities markets, namely the silver crisis of 1979-80 and events in the natural gas market in 2006.[20] The CFTC argues that had the Proposed Rule been in place at that time, then these events would not have been possible, because the speculators in question could not have taken the large positions that led to extreme silver and natural gas price fluctuations.[21] Thus, the CFTC concludes that position limits are necessary as a prophylactic measure to ensure that similar events do not recur.[22]

Although position limits may have prevented the extreme fluctuations in silver and natural gas prices in these instances, it does not follow that position limits were the only means of preventing these crises and thus *necessary* to prevent such crises from recurring. Both events took place before the CFTC had the authority to monitor commodity derivative markets comprehensively,[23] an authority granted to the CFTC by the Dodd-Frank Act. With the ability to identify market manipulation, the CFTC can now prevent comparable future events of market manipulation by utilizing its authority to intervene in markets and impose higher margin requirements or require settlement of contracts at a fair price.

The CFTC further argues that the extreme price fluctuations during the silver and natural gas crisis had a burdensome effect on the industrial and commercial sectors of the economy.[24] However, the CFTC fails to establish, or even to attempt to establish, that extreme price fluctuations due to excessive speculation exists in today's commodities markets. The CFTC therefore cannot reasonably conclude that position limits are necessary to address excessive speculation without at least contending that such speculation is affecting today's commodities markets. Indeed, a recent CFTC study found that the most recent extreme commodity price fluctuation, the 2008 crude oil crisis, was primarily due to fundamental factors in the supply and demand of oil.[25] It is further notable that the volatility of commodity markets has decreased steadily over the past decade.[26]

The CFTC also reviewed a set of 132 government and academic studies purportedly relating to the question of position limits and excessive speculation, noting that there is a lack of consensus.[27] The CFTC determines that this lack of consensus warrants "erring on the side of

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[19] Position Limits for Derivatives, 78 Fed. Reg. 75,680, 75,685 (proposed Dec. 12, 2013).
[20] *Id.* at 75,685-75,694.
[21] *Id.* at 75,692-75,693.
[22] *Id.* at 75,685-75,694.
[23] Staff of S. Comm. On Homeland Security and Governmental Affairs, 110th Cong., *Excessive Speculation in the Natural Gas Market* 1 (Comm. Print 2007).
[24] Position Limits for Derivatives, 78 Fed. Reg. 75,680, 75,689 (proposed Dec. 12, 2013).
[25] Bahattin Bu□yu□ks□ahin & Jeffrey Harris, *The Role of Speculators in the Crude Oil Futures Market*, CFTC 1 (2009).
[26] Letter from Centaurus Advisors to David Stawick, Sec'y, CFTC 1, 3 (Mar. 28, 2011).
[27] Position Limits for Derivatives, 78 Fed. Reg. 75,680, 75,694-75,695 (proposed Dec. 12, 2013).

caution" and imposing position limits.[28] However, "erring on the side of caution" is irrelevant to an assessment of whether position limits are necessary. The Committee staff also reviewed these studies and found that of them, only 27 address position limits, with the majority opposing such limits.[29] Of the total, 105 studies address whether excessive speculation is distorting prices in today's commodity markets, with 66 of these studies finding that excessive speculation is not a problem.

We urge the CFTC to conduct an analysis of whether excessive speculation is causing unreasonable price fluctuations in today's commodity markets and, if so, whether position limits would reduce unreasonable price fluctuations. If the CFTC finds that position limits would be effective and are necessary, it should calibrate position limits appropriately so as not to reduce liquidity for hedgers or impede the price discovery process.

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Thank you very much for your consideration of the Committee's position. Should you have any questions or concerns, please do not hesitate to contact the Committee's Director, Prof. Hal S. Scott (hscott@law.harvard.edu); its Executive Director of Research, C. Wallace DeWitt (cwdewitt@capmktsreg.org); or John Gulliver, Research Fellow (jgulliver@capmktsreg.org), at your convenience.

Respectfully submitted,

Robert Glenn Hubbard

R. Glenn Hubbard
CO-CHAIR

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[28] *Id.* at 75,695.
[29] The Committee staff reviewed the abstract and body of each study to determine if the author assessed: (1) whether position limits are effective at reducing speculation; or (2) whether excessive speculation is distorting prices in commodities markets. If the author presented a critical analysis of the issue, rather than just mentioning position limits or excessive speculation in passing, then the Committee staff included the study in its tally.