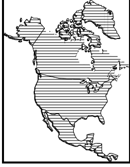

Industrial Energy Consumers of America
The Voice of the Industrial Energy Consumers

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August 4, 2014

Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
Washington, DC 20581

Re: Position Limits for Derivatives and Aggregation of Positions, RIN 3038-AD99, RIN 3038-AD82

The Industrial Energy Consumers of America (IECA) appreciates the opportunity to provide comments to the Commodity Futures Trading Commission (CFTC) on this very important proposed rule. The CFTC is to be commended for pursuing limits to speculative trading.

BACKGROUND

IECA is a nonpartisan association of leading manufacturing companies with $1.0 trillion in annual sales, over 2,900 facilities nationwide, and with more than 1.4 million employees worldwide. It is an organization created to promote the interests of manufacturing companies through advocacy and collaboration for which the availability, use and cost of energy, power or feedstock play a significant role in their ability to compete in domestic and world markets. IECA membership represents a diverse set of industries including: chemical, plastics, steel, iron ore, aluminum, paper, food processing, fertilizer, insulation, glass, industrial gases, pharmaceutical, building products, brewing, independent oil refining, and cement.

IECA member companies are some of the largest consumers of natural gas and electricity in the country, if not in the world. The member companies of IECA are mostly energy-intensive trade-exposed (EITE) companies, which means that relatively small increases to the cost of natural gas or natural gas-fired electricity can have signficant impacts on their global competitiveness. These are companies who are greatly impacted by this rulemakiing.

IECA has been an active participant at the CFTC in support of speculative position limits for over a decade, and has testified before the Commission, the Senate, and the House of Representatives on several occasions on this subject. Excessive speculation increases price volatility, separates prices from the underlying supply and demand of the commodity, and increases costs.

The commodity market is very unique as compared to other markets. Commodity markets exist for the purpose of providing a marketplace between consumers and producers of physical commodities to hedge their risks. The role of the speculator is to ensure liquidity. Historically, when markets have worked well (prior to enactment of the Commodity Futures Modernization

Act), the ratio of hedgers to speculators was about 70 to 30. Unfortunately, now, it is the reverse with about 30 percent hedgers and 70 percent speculators, or more with resulting increased volatility. As a result, the commodities market is now the playground of Wall Street speculators at the expense of bona fide hedgers. The only way to repair, or set the market right side up, is to strengthen the speculative position limits rule by imposing aggregate position limits and to ban index funds, or by applying severe limits to commodity index funds as a group or class under the law.

The position limits regime enacted in 1936 and implemented and enforced by the Commodity Exchange Commission (the predecessor to the CFTC) and the exchanges in the following decades resulted in nearly sixty years of market stability and confidence. However, this regime was weakened in the 1990s with the introduction of position accountability limits as a weaker substitute for position limits, the expansion of the bona fide hedge exemption to various financial institutions and ultimately, the enactment of the Commodity Futures Modernization Act of 2000 (CFMA). The CFMA, among other things, exempted energy futures and over-the-counter (OTC) swaps from speculative position limits. It has been since the CFMA was implemented that excessive speculation has become a problem. The Dodd-Frank Act returns speculative position limits back into the law.

Section 4a(3) as amended by the Dodd-Frank Act instructs that speculative position limits, to the maximum extent practicable, should achieve four goals:

- Diminish, eliminate or prevent excessive speculation;
- Deter market manipulation;
- Ensure liquidity for bona fide hedgers; and
- Ensure that price discovery is not interrupted.

Also, we refer to the previously submitted document by Better Markets to the CFTC on March 11, 2011 that describes in great detail, extensive analysis and empirical data, and the following facts:

- Speculation in commodity markets has dramatically increased and is excessive;
- Excessive speculation has caused increased volatility and increased prices in the futures markets;
- Price increases in the futures markets directly affect physical market prices and, thereby, have increased prices in the underlying commodities;
- While increased volatility and prices have increased the need for hedging by physical producers and purchases, the increased costs to such hedgers as a result of the above have caused physical producers and purchasers to hedge less;
- Much of this, but certainly not all, has been caused by the creation of explosive growth of commodity index funds;
- Those commodity index funds are liquidity takers and not liquidity providers while depriving bona fide hedgers of sufficient market liquidity; and
- Those commodity index funds have disrupted the commodities futures and physical markets in ways that distort price discovery.

Clearly, there is a significant record that speculation is a problem and position limits are a solution if we get the size of the position limit right.

COMMENTS ON PROPOSED RULE

1. Spot Month Position Limits Should Be Lower

IECA supports setting speculative position limits on natural gas, electricity and propane. However, the CFTC proposed rule will be ineffective at reducing excessive speculation because it sets the speculative position limits too high. We also urge the CFTC to reduce speculative position limits on passive traders, such as index funds, or ban them all together.

With respect to the *spot-month position limits*, the CFTC estimates based on historical data that no more than 148 traders in any energy referenced contract would hold or control positions that would exceed a spot-month limit. With respect to the *non-spot-month position limits*, the CFTC estimates based on historical data that no more than 11 traders in any energy referenced contract would hold or control positions that would exceed either a single month or all months combined limit.

The proposed rule would allow a non-commercial trader to hold futures contracts for 25 percent of deliverable supply. This is too large. The CFTC has not provided justification for allowing each non-commercial trader the ability to control 25 percent of the deliverable supply. This is a lot of market power in the hands of speculators.

Do the math and it spells market power

Total natural gas demand for 2013 was 26.0 Tcf or 2.17 Tcf per month. The proposed rule would allow a trader to hold up to 25 percent of deliverable supply or a monthly amount of 2.17 Tcf of natural gas futures. If the 148 traders mentioned by the CFTC maxed out on their position limit, they would control 321.2 Tcf of natural gas! This is an amount that is 148 times larger than deliverable supply for a given month. Even if only half of the traders maxed out on their position limit, the amount of control over the physical commodity at 74 times the deliverable supply is alarming.

We urge you to NOT implement a position limit that could give non-commercial traders control over 25 percent of the deliverable supply. Instead, we recommend 5 percent of deliverable supply. At 5 percent of deliverable supply, the 148 non-commercial traders would potentially be able to control a substantial amount of the deliverable supply at 16.03 Tcf or 7.4 times the deliverable monthly supply. A 5 percent speculative position would provide ample liquidity and significantly reduce the potential for excessive speculation.

2. Spot Month Position Limit Should Be Subject to Annual Review

The proposed rule calls for review of the spot month position limit on a biennial basis (every two years). The CFTC has stated that “biennial updates would reduce the burden on market participants in updating speculative position monitoring systems.” We do not see how reviewing position limits more often is a burden. The CFTC regularly monitors volatility of the market as part of its market oversight. On any one day, they know if there is an increase or decrease in the levels of speculation and volatility. With this knowledge, on an annual basis, the CFTC should be able to review whether the existing position limit is serving its purpose. If after an annual

review, the CFTC finds that the position limit needs to change, informing the market players in this electronic world should be quick and easy.

3. IECA Strongly Opposes Creation of a Conditional Spot Month Limit Exemption

The proposed rule would provide for the creation of a "conditional spot month limit" that would allow a non-commercial trader to hold up to five times the spot month limit if such positions are held exclusively in cash-settled contracts and if the trader did not hold or control position in a spot-month physical-delivery referenced contract. Given that the initial spot month position limit would be set at 25 percent of deliverable supply as mentioned above, the conditional spot month limit would initially be set at 125 percent of deliverable supply.

Here again, there is absolutely no justification for this. How is it possible that allowing a non-commercial entity to control 125 percent of the deliverable supply is consistent with reducing or preventing excessive speculation? We have not seen any rationale as to why this would be a benefit. We find it incredible that in a rulemaking that is supposed to reduce excessive speculation and volatility that the CFTC would even think about including this provision. This could be very damaging to the markets.

4. Commodity Index Funds Should be Banned from Participating in the Futures Market – Should Not Be Considered a Bona Fide Hedge

IECA supports banning commodity index funds from participating in the futures market. One of the major reasons that speculation in consumable commodities has grown so dramatically in the last decade is the significant rise in passive speculation by those seeking to "invest" in commodity derivatives through index funds. These are individuals or entities who, for example are seeking to invest in commodities just as they would in stocks or bonds. The commodity futures market was never designed for this type of passive investor. Today, passive speculators outnumber active speculators and account for the lion's share of speculative open interest in many consumable commodities.

Active speculators and passive speculators are very different. Active speculators add beneficial liquidity to the market by buying and selling futures contracts with the goal of a relatively quick profit. Passive speculators do the opposite; they drain liquidity by buying and holding large quantities of futures contracts. They act like a consumer who never takes actual delivery of the goods.

Passive speculators invest in a commodity or a basket of commodities (an index fund) and continually roll their positions forward as part of a diversification strategy. The strategy is completely blind to what is happening on supply or demand and the realities of the market. This is a huge contrast to the active speculator who seeks to financially benefit from changes to the market and is ready to buy or sell based on market activity.

Passive speculators not only undermine, they destroy the price discovery function of the market and increase the potential for price bubbles like we saw for natural gas in August 2008. The harm caused by commodity index funds has been well documented. The June 2009 report of the Senate Permanent Subcommittee for Investigation (PSI) on the role of excessive speculation in the wheat market is just one example. This bipartisan report concluded that the "activities of

commodity index traders, in the aggregate, constituted 'excessive speculation,'" and that index funds have caused "unwarranted price changes" and constitute an "unwarranted burden on commerce." The PSI report urged the CFTC to take appropriate measures to limit the impact of index fund investments in commodities.

5. Support for Speculative Position Limits on Futures, Options, Swaps

For clarity, IECA supports speculative position limits on futures, options and swaps. Each financial instrument can be used to develop market power and increase volatility, unless there are appropriate speculation position limits.

In conclusion, we would like to offer our thanks to Chairman Timothy Massad, Commissioner Scott O'Malia, and the CFTC staff for all of their efforts on this rule. We urge you to set speculative position limits to 5 percent of deliverable supply and ban index funds from participating in the futures markets.

Sincerely,

Paul N. Cicio
President