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July 13, 2016

U.S. Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21<sup>st</sup> St NW  
Washington, DC 20581

**Re: RIN # 3038-AD99**

Public Citizen, Inc. submits these comments to the supplemental notice of proposed rulemaking in *Position Limits for Derivatives: Certain Exemptions and Guidance*.

Public Citizen is a national, nonpartisan, not-for-profit research and advocacy organization representing the interests of our more than 400,000 household members and supporters across the United States. Both our audited financial statements and fiscal year annual reports filed with the U.S. Internal Revenue Service are available on our website.<sup>1</sup> Public Citizen's Energy Program Director, Tyson Slocum, serves as one of nine members of the CFTC's Energy and Environmental Markets Advisory Committee.

Our comments focus on one crucial and problematic change this supplemental made to its December 2013 proposed rulemaking: the Commission deferring to private, for-profit exchanges the front-line authority to grant bona fide hedge exemptions from position limits. Allowing for-profit exchanges to determine hedge exemptions from federal position limits places these clearinghouse corporations in a conflict of interest, and subverts the CFTC to a lessor, after-the-fact regulator of position limits. If the exchanges are to be involved at all in granting hedge exemptions to position limits, it should be limited to an advisory capacity, with both the initial, and final, hedge exemption determinations made by CFTC staff. The evidence shows that the for-profit exchanges are inappropriate agents to make front-line hedge exemption determinations because their business models present inherent conflicts of interest to perform such federal law enforcement activities, and this supplemental rulemaking fails to mitigate this conflict of interest. In addition, recent settlements by

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<sup>1</sup> [www.citizen.org/Page.aspx?pid=2316](http://www.citizen.org/Page.aspx?pid=2316)

regulators against exchanges demonstrate that these corporations have difficulty complying with the law, raising questions about their ability to effectively enforce it.

A regulatory agency granting for-profit corporations with inherent conflicts of interest the authority to enforce a critical reform enacted by Congress is unprecedented.

As a result, Public Citizen calls on the CFTC to abandon allowing for-profit, corporate exchanges from having any role in granting hedge exemptions to federal position limits other than in an advisory capacity. The CFTC alone must be the agency determining hedge exemptions for federal position limits.

### **Background**

Section 737 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ordered that “the Commission shall by rule, regulation, or order establish limits on the amount of positions, as appropriate, other than bona fide hedge positions, that may be held by any person with respect to contracts of sale for future delivery or with respect to options on the contracts or commodities traded on or subject to the rules of a designated contract market.”<sup>2</sup> The purpose of establishing such position limits is to restrict the ability of any single trader or a small group of traders from dominating or controlling the market, to help ensure that a given market—and the prices it produces—is sufficiently competitive, and not unduly encumbered by excessive levels of speculation. Household consumers are protected when effective, and firm, position limits are employed.

The December 2013 proposed Position Limits rulemaking provided no front-line authority for exchanges to determine bona fide hedge exemptions to position limits. But the supplemental proposed rulemaking at issue here introduces a radical new proposal: allowing exchanges to make the determination of whether a bona fide hedge exemption from CFTC-established position limits is granted, thereby placing significant position limit enforcement in the hands of the exchanges. The supplemental proposed rule allows the CFTC to review the exchanges’ hedge exemption decisions, but does not explicitly require it. And any CFTC review that does happen to occur may potentially happen after the exemption has already been granted, and, therefore, after any potential market impact. This places the CFTC in a subservient role to the for-profit exchanges in being able to enforce position limits as dictated by Congress.

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<sup>2</sup> Public Law No. 111-203, [www.congress.gov/111/plaws/publ203/PLAW-111publ203.pdf](http://www.congress.gov/111/plaws/publ203/PLAW-111publ203.pdf)

## The Exchanges and Conflicts of Interest

Two for-profit corporations—CME Group, Inc. and Intercontinental Exchange, Inc. (ICE)—dominate the commodity clearinghouse market. Among other things, commodity clearinghouses can provide counterparty risk mitigation and price reporting services for energy producers, consumers and speculators alike. Historically, clearinghouses were not-for-profit or member-owned associations. But in the last 16 years, a combination of deregulation and organizational changes shifted the exchange structure to for-profit corporations.

As Public Citizen Energy Program Director Tyson Slocum stated in a formal dissent report to the CFTC Energy and Environmental Markets Advisory Committee in February 2016,<sup>3</sup> this shift to exchanges operating as for-profit corporations has transformed the operational goals of exchanges. There are three primary methods CME and ICE derive profit: clearing and transaction fees based upon trading volume; collecting, packaging and selling propriety data based on information gleaned from trading activity on their exchanges; and hawking preferential market access, such as co-location and other services.

The higher the trading volume in an offered product, the higher the profit-making opportunities for the exchanges. Conversely, the lower the trading volume, typically the lower the profit-making opportunities. Simply browsing CME's Twitter feed,<sup>4</sup> for example, reveals hundreds of posts boasting on a daily basis of ever-higher trading volumes in a variety of products that the company offers. CME's most recent 10-k annual report filed with the U.S. Securities and Exchange Commission describes a variety of incentive programs it offers for its customers to increase trading volume, offering "volume discounts and limits on fees" and "various incentive programs to promote trading" for those customers.<sup>5</sup> The *Financial Times* reported that CME, in an effort to break into a North Sea oil contract dominated at the time by rival ICE, offered a bonus of as much as \$1 million per month to the largest traders in its new, competing Brent crude futures product.<sup>6</sup> Such "volume bonuses" undermine efforts for an exchange to determine hedge exemptions for position limits.

Profiting off of these activities can directly interfere with the exchange's functions as market monitors and enforcers. While the exchanges maintain that they feature strong internal firewalls, the integrity of those firewalls are verified internally, and not by outside parties.

<sup>3</sup> [www.citizen.org/documents/dissent-report-CFTC-february-2016.pdf](http://www.citizen.org/documents/dissent-report-CFTC-february-2016.pdf)

<sup>4</sup> <https://twitter.com/CMEGroup>

<sup>5</sup> At page 32, [www.sec.gov/Archives/edgar/data/1156375/000115637516000116/cme-2015123110k.htm](http://www.sec.gov/Archives/edgar/data/1156375/000115637516000116/cme-2015123110k.htm)

<sup>6</sup> Ajay Makan & Gregory Meyer, "CME under fire over cash for trades in Brent," August 18, 2013.

But the Congressional position limit mandate could result in lower trading volumes for the exchanges. The supplemental proposed rulemaking by the CFTC allowing the two for-profit exchanges to determine position limit exemptions contains no mitigation measures to ensure that the exchanges won't be making such exemption determinations based upon their own financial self-interest. The exchanges' claims that their internal firewalls prevent such self-serving behavior crumbles under scrutiny and experience of broader firewall failures leading up to the 2008 financial crisis and the accounting scandals pre-Sarbanes-Oxley.

Recent settlements by federal regulators with the exchanges demonstrate that both corporations have difficulty cooperating with current laws and regulations, and cast doubt on their ability to independently enforce the law. In March 2015, the CFTC forced ICE to pay a \$3 million civil penalty for repeated data reporting violations over a 20-month period. Part of the reason the CFTC demanded ICE pay the civil penalty was due to the company's insubordination and lack of responsiveness to Commission requests: "ICE did not respond in a timely and satisfactory manner to inquiries from CFTC staff from multiple divisions about these data-reporting issues, including initial inquiries from the Division of Enforcement."<sup>7</sup> The CFTC was forced to sue CME in federal court in 2013 for violating internal firewalls and selling confidential trading information to an outside broker.<sup>8</sup> These transgressions inspire little confidence within the public interest community that for-profit exchanges can be responsible for enforcing critical components of Dodd-Frank.

The vested financial interest of the corporate structures of both ICE and CME are reflected in their federal lobbying advocacy. A review of Lobbying Disclosure Reports the companies file with Congress reveal that the companies spend millions of dollars a year to influence the legislative and regulatory process, and to promote legislative and regulatory policies that facilitate growth of trading volume, thereby undermining the companies' proposed new roles as chief enforcers of federal position limits. For example, CME spends more than \$300,000 every three months lobbying Congress and the CFTC.<sup>9</sup> CME employees at least three outside lobbyists, including the services of former CFTC Chairman Jim Newsome's Delta Strategy Group.<sup>10</sup> CME also pays Davis & Harman LLP<sup>11</sup> and Ogilvy Government Relations<sup>12</sup> to lobby the federal government on its behalf.

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<sup>7</sup> [www.cftc.gov/PressRoom/PressReleases/pr7136-15](http://www.cftc.gov/PressRoom/PressReleases/pr7136-15)

<sup>8</sup> Kara Scannell, "CFTC sues Nymex over information leaks," *The Financial Times*, February 21, 2013.

<sup>9</sup> <http://disclosures.house.gov/ld/ldxmlrelease/2016/Q1/300793637.xml>

<sup>10</sup> <http://disclosures.house.gov/ld/ldxmlrelease/2016/Q1/300803653.xml>

<sup>11</sup> <http://disclosures.house.gov/ld/ldxmlrelease/2016/Q1/300793701.xml>

<sup>12</sup> <http://disclosures.house.gov/ld/ldxmlrelease/2016/Q1/300796971.xml>

CME operates a Political Action Committee, an entity controlled by CME management that disburses cash payments to federal political candidates' election efforts. Since the 2010 election cycle, CME's PAC has given \$3 million to candidates running for federal political office.<sup>13</sup>

ICE spends more than \$800,000 every three months to influence federal legislation and regulations,<sup>14</sup> and hires at least two outside lobbying firms, The Cypress Group<sup>15</sup> and Alan Sobba,<sup>16</sup> the CFTC's former top liaison to Congress. In addition, the ICE PAC has provided \$600,000 to federal politicians running for office since the 2010 cycle.<sup>17</sup>

These expensive lobbying and campaign finance strategies belie the notion that the exchanges' priority is enforcement. The exchanges primary interest in lobbying Congress and federal regulators is to promote those policies that will grow trading volumes to help increase profits. Providing the exchanges with the authority to grant hedge exemptions from federal position limits can be seen as a potential tool to give the exchanges—and not regulators like the CFTC—increased leverage to influence the trading volumes that are central to their profits.

## **Conclusion**

It is inappropriate to allow for-profit corporate exchanges to have authority to determine hedge exemptions from federal position limits because the two major exchanges, CME and ICE, feature inherent conflicts of interest precluding them from effectively serving this role. Public Citizen therefore urges the CFTC to preserve the granting of hedge exemption authority for federal position limits solely to the CFTC, and limit the involvement of the exchanges to an advisory role.

Respectfully submitted,

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<sup>13</sup> [www.opensecrets.org/pacs/lookup2.php?strID=C00076299&cycle=2016](http://www.opensecrets.org/pacs/lookup2.php?strID=C00076299&cycle=2016)

<sup>14</sup> <http://disclosures.house.gov/ld/ldxmlrelease/2016/Q1/300799213.xml>

<sup>15</sup> <http://disclosures.house.gov/ld/ldxmlrelease/2016/Q1/300799405.xml>

<sup>16</sup> <http://disclosures.house.gov/ld/ldxmlrelease/2016/Q1/300805175.xml>

<sup>17</sup> [www.opensecrets.org/pacs/lookup2.php?strID=C00443168&cycle=2016](http://www.opensecrets.org/pacs/lookup2.php?strID=C00443168&cycle=2016)