# STATEMENT OF
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# CME GROUP INC.
# BEFORE THE
# COMMODITY FUTURES TRADING COMMISSION
# MEETING ON METALS POSITION LIMITS AND HEDGE EXEMPTIONS
# MARCH 25, 2010

I am Thomas LaSala, Managing Director and Global Chief Regulatory Officer of CME Group Inc. ("CME Group"). CME Group is the holding company for four separate Exchanges, including Chicago Mercantile Exchange Inc. ("CME"), the Board of Trade of the City of Chicago, Inc. ("CBOT"), the New York Mercantile Exchange, Inc. ("NYMEX") and the Commodity Exchange, Inc. ("COMEX"). CME Group, on behalf of its four designated contract markets ("CME Group Exchanges," "Exchanges" or "DCMs"), appreciates the opportunity to provide its views to the Commodity Futures Trading Commission (the "CFTC" or "Commission") in conjunction with the Commission's decision "to review the potential application of federal position limits and exemptions from position limits in metal markets."

The CME Group Exchanges offer the widest range of benchmark products available across all major asset classes, including futures and options on futures based on interest rates, equity indexes, foreign exchange, energy, metals, agricultural commodities, and alternative investment products. CME Clearing is one of the largest central counterparty clearing services in the world; it provides clearing and settlement services for exchange-traded contracts, as well as for over-the-counter ("OTC") derivatives contracts through CME ClearPort®. Using the CME ClearPort® service, eligible participants can execute an OTC swap transaction, which can be transformed into a futures or options contract that is subject to the full range of Commission and exchange-based regulation and reporting. The CME ClearPort® service mitigates counterparty credit risks, provides transparency to OTC transactions and brings to bear the exchange's market surveillance monitoring tools.

The CME Group Exchanges serve the hedging, risk management and trading needs of our global customer base by facilitating transactions through the CME Globex® electronic trading platform, our open outcry trading facilities in New York and Chicago, as well as through privately negotiated transactions.

Before I address the specific questions posed by the Commission, I would like to note that, while today's meeting is being held to discuss the imposition of position limits and hedge exemptions in metals, two factors strongly militate against the Commission taking any action. First, as discussed in more detail below, COMEX has effectively exercised its regulatory authority to prevent congestion or any other market distorting events that are related to trading and delivery of its metals contracts. Second, the only impact that CFTC-imposed limits will have in the metals markets will be to shift business away from U.S. exchanges to less regulated or even wholly unregulated markets that are beyond the Commission's jurisdictional reach. To

be sure, the metals markets are global and a significant portion of these markets operate outside the U.S. and are easily accessible to our market participants. This second point leads me to the Commission's first question.

In question one, the Commission asks "How does price discovery occur in the metal markets, considering both the cash and derivative markets as well as domestic and international markets?"

Because a significant portion of the metals markets exists outside the U.S., price discovery in these commodities is a function of the combined trading of the cash and derivatives markets in the U.S. and their counterparts internationally. Thus, no one market controls the price discovery process in the metals 24-hours a day. In fact, the system operated by the London Bullion Market Association ("LMBA") contributes significantly to the price discovery function in metals commodities. For example, the gold and silver fixing conducted by LBMA and the volume of trade and deliveries renders London very influential in the price discovery process of the gold and silver markets.[1] With respect to the silver market specifically, an exceptionally thorough and informative speech was delivered at the 2009 LBMA Precious Metals Conference by James Steel, Chief Commodities Analyst, Precious Metals, HSBC.[2] Mr. Steel traces the history of the silver market from the days of the Conquistadors to the rise of the City of London, to New York's attempt to capture the market and finally back to London. He concludes, with authority:

> Nowhere in the world is there a single location where these services can all be provided. The overwhelming majority of silver trading is done on the OTC markets, which are cleared in London in much the same way as dollars are cleared in New York and Yen are settled in Tokyo. Silver is settled in London, much like a current or checking account at your local bank. Bullion traders from all over the world have traditionally maintained precious metals accounts with members of the LBMA. This has allowed for dealers around the world to settle bullion transactions between each other by transfers between London dealers. This puts loco London at the centre of world silver trading and the price quoted for loco London is in fact the world price for silver, i.e. it is the benchmark for silver, just as West Texas intermediate is the benchmark for world oil prices.

Similar to the influence in London with regard to the gold and silver markets, China contributes immensely to price discovery in the platinum and palladium markets, while London and China play equally important roles in price discovery in copper. Accordingly, position limits imposed by the Commission in metals markets cannot reasonably be justified based on protection of the price discovery function.

Despite the fact that prices for metals commodities are not controlled by U.S. markets, some speculators, including the Gold Anti-Trust Action Committee (GATA), have persistently

[1] A clear description of the gold and silver fixing and of the establishment of Gold Forward Offered Rates is provided at the LMBA website, available at http://www.lbma.org.uk/stats/statsfaqs.

[2] Available at http://www.lbma.org.uk/docs/conf2009/SteelTranscript.pdf.

drawn media attention to their baseless charges that the short sellers at COMEX are manipulating, or more politely, depressing gold and silver prices. There is, however, no rational theory, real data or other evidence to support their claims. In fact, the premise for their theory was proved false by the Commission in its 2008 report titled "Report on Large Short Trader Activity in the Silver Futures Market" (the "Silver Report").

In the Silver Report, the Commission addressed complaints from the previous 20-25 years from silver investors alleging that the price of silver futures on COMEX was being manipulated downward by "a small group of traders on the short side of the market." (Silver Report at 1.) After looking at price movements in the Silver Market vis-a-vis prices of other metals, the relationship between the prices of COMEX silver futures and spot silver prices, concentration of futures traders' positions, the composition of large short position silver traders, the relationship between traders' concentration levels and silver futures prices, and the relationship between the positions held by large short silver futures traders and silver futures prices, the Commission rejected these complaints and concluded:

- There was no evidence of manipulation in the silver futures market.
- Silver cash and futures prices rose dramatically between 2005 and 2007, with silver outperforming the gold, platinum and palladium markets, suggesting that silver futures prices were not depressed relative to other metals prices.
- COMEX silver futures prices tended to track closely the price of physical silver.
- Concentration levels for the top four short futures traders in the silver futures market were comparable to those observed in the gold and copper futures markets, and generally were lower than the levels seen in the platinum and palladium futures markets.
- The composition of the traders comprising the top four short futures traders, in terms of net positions, changed over time. These traders represented a diverse group, and their futures positions were driven by an even more diverse group of customers.
- There was no observable relationship between short-futures-trader concentration levels and silver prices.
- There was a slightly positive relationship between the total net position of the large short futures trades and silver prices; this suggested that larger short futures positions were associated with higher, not lower prices. (Silver Report at 1-2.)

The Silver Report updated the Commission's findings from 2004 in response to almost identical complaints respecting manipulation in the silver futures market; these complaints also were dismissed by the Commission as being unsupported and illogical. (Silver Report at 3.) Like the complaints leading to the previous investigation, the advocates of depressed silver prices failed to indicate where prices should be nor did they ever offer a "credible explanation as to why, for more than 25 years, buyers have not entered the market to purchase silver (at the supposedly depressed prices), thereby driving up prices to a level that [they] believe is reasonable." (Silver Report at 5.) In fact, the Commission's data for the preceding three years

showed that, contrary to the commentators' allegations, silver prices actually increased. (Silver Report at 6.) Finally, the Commission found that under no circumstances could the alleged manipulative scheme have been effectuated by four traders as contended; rather, at least 10 traders would have needed to be involved in order for it to work. (Silver Report at 9.)

Significantly, like the speculators currently complaining about allegedly depressed gold and silver prices, the commentators whose complaints lead to the Silver Report referenced the Hunt brothers' manipulation in the late 1970s and early 1980s. The Commission rejected the comparison, noting that the situation involving the Hunt brothers involved very high silver prices, caused in part by the Hunts' manipulative trading. The Commission explained:

> In that situation, the Hunts held significant long positions in both the physical silver market and the silver futures markets. As prices began to fall, the Hunts were forced to sell their physical silver holdings to meet the margin calls on their long futures positions and to sell futures contracts to attempt to stem their losses on the futures positions. Ultimately, the selling of silver in both markets led to a precipitous collapse in prices. *By contrast*, *the net positions of the large shorts in the silver futures market appear to be market neutral, as opposed to the overwhelmingly long positions held by the Hunts. Therefore, liquidation by the large shorts today would not be expected to have the same overall impact on prices that was experienced at the time of the Hunts' liquidation.*" (Silver Report at 12 (emphasis added).)

A recent letter from GATA to the Commission regarding the allegedly depressed gold and silver prices today illustrates the striking similarity to the complaints subject of the Silver Report:

> GATA has long implicated the New York Commodities Exchange (Comex) as being a mechanism by which gold and silver price suppression is implemented. The smoking gun is the excessive concentration of bullion bank positions in the gold and silver futures markets. This concentration enables market manipulation — just as market concentration was the justification offered by the CFTC in 1980 when it acted against the Hunt Brothers in the silver market.
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> The [CFTC's] weekly commitment of traders report documents the total net short position of commercial traders in the commodity markets. The monthly bank participation reports disclose the holdings of U.S. banks in various markets. In a letter to GATA dated February 19, 2009, Laura Gardy, a CFTC legal assistant, wrote, "The commission determined that where the number of banks in each reporting category is particularly small, fewer than four banks, there exists the potential to extrapolate both the identity of individual banks and the banks' positions. As a result, as of December 2009 the CFTC no longer names the number of banks when it is less than four."

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> The CFTC's own reports of November 2009 show that just two U.S. banks held 43 percent of the commercial net short position in gold and 68 percent of the commercial net short position in silver. In gold, these two banks were short 123,331 contracts but long only 523 contracts, and in silver they were short 41,318 contracts and long only 1,426 contracts. How improbable is it that these two banks attract most of the investors who want only to sell short?
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> GATA has evidence that there are enormous physical short positions in the gold and silver markets that cannot be covered. Because of the decades-long interference with the gold market, we estimate that the free-market price of gold is multiples of the current price. Growing stress caused by burgeoning physical bullion demand is threatening to lead to a price explosion, which will restore to the market the balance that regulation has failed to maintain. In our view, the Comex paper market will become dysfunctional, with "force majeure" having to be declared as the concentrated shorts are unable to deliver on their obligations. (March 8, 2010 Letter from GATA to CFTC.)

Like the complaints that led to the Silver Report, the current complaints, such as GATA's, lack credible evidence or even a sensible theory to support the allegations that manipulation is causing metals prices to be depressed today. Therefore, no action – especially the imposition of position limits – is warranted by the Commission.

Not only is there no market justification for the imposition of hard position limits in the metals commodities, doing so would run contrary to the national policy of enhancing transparent markets by, among other things, central counterparty clearing – a policy which was reaffirmed by Congress in its amendments to the Commodity Exchange Act (CEA) in 2008. As previously noted, the metals markets are global, providing market participants with a multitude of easily accessible venues world-wide in which to trade metals products. Imposing artificial limits in the metals commodities will only have the unintended consequence of encouraging U.S. market participants to move away from the best regulated, most transparent, safest marketplace to less regulated or even completely unregulated markets that are and will continue to be beyond the control of the Commission and Congress. The threat of the Commission imposing such limits has already driven substantial business off U.S. exchanges to trading venues overseas.

Several of the other questions, particularly questions five and six, lose their immediacy once the price discovery process in the metals markets is appreciated. Nonetheless, question two, which was recently added to the agenda, deserves analysis.

In question two, the Commission asks, "[w]hat is the role of passive, long-only positions such as those associated with index funds or exchange-traded funds in the metals markets and how might their trading activities and potential market impact roles relate to the consideration of position limits?" This question appears to be an effort to reopen the debate regarding the impact of passive index trading on wheat and other agricultural commodities. There is, however, no reason to reopen this debate as competent economic evidence consistently has refuted all claims

respecting any adverse impacts of indexed investing on agricultural futures markets and on the underlying cash prices.

Question two, however, raises another important issue in that it appears to conflate index funds and exchange-traded funds ("ETFs") in metals. Index trading on futures markets and exchange traded funds in metals are very different and, consequently, can have two very different effects on commodity prices.

As an initial matter, the assumption that "passive" long only index funds actually are passive is incorrect. In fact, these funds are made up of tens of thousands of individual investors, each of whom makes a decision each day as to whether to remain in the market on the long side. In fact, an investor can choose to move his investment from a long ETF to a short or even a leveraged short ETF at any time during the trading day. The irrefutable evidence has shown that these index funds invest and disinvest based on thousands of individual decisions and simply are a convenient and efficient vehicle for individual investors to enter and exit the market.

Index funds operating on futures exchanges have no impact on the underlying commodity and have only a transitory and insignificant impact on the prices of futures contracts. For example, a gold trader in New York might up her offer if there is unusual short term buying from an index fund and the trader guesses what is moving the market, but twice a day the London gold fix takes place and prices at the COMEX must come into line—arbitrage or EFP delivery is too easy to allow significant deviations to persist. The London gold fix is not impacted by index trading on a futures exchange, since no gold is taken from storage or consumed by index trading on futures exchanges. (The index funds exit the market prior to the delivery period.) Thus, index funds operating on futures exchanges have no impact on the underlying commodity and have only a transitory and insignificant impact on the prices of futures contracts. Accordingly, the fantasy that indexed trading in gold futures has an adverse impact on the prices on COMEX cannot persist.

ETFs involving gold and silver are traded on security exchanges, in the U.S. and elsewhere. The ETFs are backed by gold and silver purchased by the fund operator and held in allocated or unallocated accounts in the name of the fund. Sizable stocks of silver and gold have been devoted to backing ETFs. There arguably is some possibility that the purchase of those stocks may impact prices, however, that issue is beyond the scope of our response today.

In question three, the Commission asks "[c]ould and should speculative position limits be applied consistently across all metals derivatives markets and participants, including index traders and managers of Exchange Traded Funds?" If an all-powerful and all-knowing entity could set a world limit for derivative trading and ownership of refined metal, ore and reserves for speculative purposes, (if speculative purposes could be defined in this context), why would she want to do that? Surely it is necessary that a significant benefit must be defined before that degree of regulatory effort is expended. Therefore, even if authority existed to curtail speculation in metals derivatives and in the underlying commodity, we do not believe that any net social benefit would be created by such restrictions on the free market.

Furthermore, in addition to the reasons discussed in response to questions one and two, we do not believe there is any reason to deviate from the existing limits regime. As CME Group has previously testified, we believe that an exchange is best suited to police activity in its market, set position limits and assess whether a hedge exemption is appropriately granted to a particular customer. This principle is recognized many times by the CEA and the Commission's Regulations and past practices. Under the CEA, exchanges have a continuing responsibility respecting position limits.[3] The exchanges' obligations are set forth in the Commission's Core Principle 5[4] for designated contract markets ("DCM"), which requires boards of trade to adopt

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[3] 46 Fed. Reg. 50938, 50939.

[4] Core Principle 5 provides:

*POSITION LIMITATIONS OR ACCOUNTABILITY*—To reduce the potential threat of market manipulation or congestion, especially during trading in the delivery month, the board of trade shall adopt position limitations or position accountability for speculators, where necessary and appropriate.

(a) *Application guidance.* [Reserved]

(b) *Acceptable practices.* (1) In order to diminish potential problems arising from excessively large speculative positions, and to facilitate orderly liquidation of expiring futures contracts, markets may need to set limits on traders' positions for certain commodities. These position limits specifically may exempt bona fide hedging, permit other exemptions, or set limits differently by markets, by delivery months, or by time periods. For purposes of evaluating a contract market's speculative-limit program, the Commission considers the specified limit levels, aggregation policies, types of exemptions allowed, methods for monitoring compliance with the specified levels, and procedures for enforcement to deal with violations.

(2) Provisions concerning speculative position limits are set forth in part 150. In general, position limits are not necessary for markets where the threat of excessive speculation or manipulation is nonexistent or very low. Thus, contract markets do not need to adopt speculative position limits for futures markets on major foreign currencies, contracts based on certain financial instruments having very liquid and deep underlying cash markets, and contracts specifying cash settlement where the potential for distortion of such price is negligible. Where speculative position limits are necessary, acceptable speculative-limit levels typically should be set in terms of a trader's combined position in the futures contract plus its position in the related option contract (on a delta-adjusted basis).

(3) A contract market may provide for position accountability provisions in lieu of position limits for contracts on financial instruments, intangible commodities, or certain tangible commodities. Markets appropriate for position accountability rules include those with large open-interest, high daily trading volumes and liquid cash markets.

(4) Spot-month limits should be adopted for markets based on commodities having more limited deliverable supplies or where otherwise necessary to minimize the susceptibility of the market to manipulation or price distortions. The level of the spot limit for physical-delivery markets should be based upon an analysis of deliverable supplies and the history of spot-month liquidations. Spot-month limits for physical-delivery markets are appropriately set at no more than 25 percent of the estimated deliverable supply. For cash-settled markets, spot-month position limits may be necessary if the underlying cash market is small or illiquid such that traders can disrupt the cash market or otherwise influence the cash-settlement price to profit on a futures position. In these cases, the limit should be set at a level that minimizes the potential for manipulation or distortion of the futures contract's or the underlying commodity's price. Markets may elect not to provide all-months-combined and non-spot month limits.

(5) Contract markets should have aggregation rules that apply to those accounts under common control, those with common ownership, i.e., where there is a ten percent or greater financial interest, and those traded according to an express or implied agreement. Contract markets will be permitted to set more stringent aggregation policies. For example, one major board of trade has adopted a policy of automatically aggregating the position of members of the same household, unless they were granted a specific waiver. Contract markets may grant exemptions to their position limits for bona fide hedging (as defined in §1.3(z) of this chapter) and may grant exemptions for reduced risk positions, such as spreads, straddles and arbitrage positions.

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position limits or position accountability where necessary and appropriate, and the Commission, in evaluating a contract market's speculative limit program, considers the specific limit levels, aggregation policies, the types of exemptions allowed, and the methods for monitoring and enforcing compliance with the limits. At the CME Group, our practice consistently has been to consult closely with Commission staff before initiating any changes to our exchange rules concerning limits in our metals complex.

With respect to contracts in metals commodities, the Acceptable Practices for Core Principle 5 specifically provide that exchanges do not need to adopt position limits.[5] Moreover, the Acceptable Practices specifically provide that exchanges may provide for position accountability provisions in lieu of position limits for contracts in markets with large open-interest, high daily trading volumes and liquid cash markets. Furthermore, with respect to spot-month limits, the Acceptable Practices provide that the level of the spot limit for physical-delivery markets should be based upon an analysis of deliverable supplies and the history of spot-month liquidations and that such limits are appropriately set at no more than 25 percent of the estimated deliverable supply. For cash-settled markets, spot-month position limits may be necessary if the underlying cash market is small or illiquid such that traders can disrupt the cash market or otherwise influence the cash-settlement price to profit on a futures position. Finally, the Acceptable Practices provide that markets may elect not to provide all-months-combined and non-spot month limits.

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(6) Contract markets with many products with large numbers of traders should have an automated means of detecting traders' violations of speculative limits or exemptions. Contract markets should monitor the continuing appropriateness of approved exemptions by periodically reviewing each trader's basis for exemption or requiring a reapplication.

(7) Contract markets should establish a program for effective enforcement of these limits Contract markets should use their LTRS to monitor and enforce daily compliance with position limit rules. The Commission notes that a contract market may allow traders to periodically apply to the contract market for an exemption and, if appropriate, be granted a position level higher than the applicable speculative limit. The contract market should establish a program to monitor approved exemptions from the limits. The position levels granted under such hedge exemptions generally are based upon the trader's commercial activity in related markets. Contract markets may allow a brief grace period where a qualifying trader may exceed speculative limits or an existing exemption level pending the submission and approval of appropriate justification. A contract market should consider whether it wants to restrict exemptions during the last several days of trading in a delivery month. Acceptable procedures for obtaining and granting exemptions include a requirement that the contract market approve a specific maximum higher level.

(8) Finally, an acceptable speculative limit program should have specific policies for taking regulatory action once a violation of a position limit or exemption is detected. The contract market policy should consider appropriate actions, regardless of whether the violation is by a non-member or member, and should address traders carrying accounts through more than one intermediary.

(9) A violation of contract market position limits that have been approved by the Commission is also a violation of section 4a(e) of the Act. The Commission will consider for approval all contract market position limit rules.

[5] *See,* Acceptable Practices (2), "Thus, contract markets do not need to adopt speculative position limits for futures markets on major foreign currencies, contracts based on certain financial instruments having very liquid and deep underlying cash markets, and contracts specifying cash settlement where the potential for distortion of such price is negligible."

The limits regime in place at COMEX in its metals markets fully complies with the CEA and the Commission's' Regulations.[6] We employ position limits in our metals complex during the last business day of trading before the delivery month begins through the third week of the delivery month and position accountability levels at other times to avoid congestion and other market disrupting events that may flow from excessive concentrations of positions. Nothing we have heard or read discredits the principles on which that policy was built. Although our administration of accountability levels in the metal complex may not be broadly understood by the public, it is certainly understood by the Commission's Division of Market Oversight ("DMO"), as it is routinely subject to rule enforcement review by DMO.

Position accountability provisions provide a formal means for an exchange to monitor traders' positions that may threaten orderly trading. A position accountability approach establishes threshold position levels that may be exceeded, but once a trader breaches such accountability levels, the exchange may initiate an inquiry to examine the trader's rationale for holding the large position and whether the position poses a threat of manipulation or could otherwise be disruptive to the market.

A position accountability regime also allows exchange regulatory staff, if warranted, to order a trader with a position in excess of accountability levels not to further increase his position. If a trader fails to comply with a request for information about positions held, provides information that does not sufficiently justify the position, or continues to increase contract positions after a request not to do so is issued by the exchange, the accountability provision in Exchange rules provide authority for the Compliance Department to require the trader to limit or reduce his positions.[7] A failure to do so is deemed a rule violation.

The CME Exchanges set accountability levels low to obtain an early alert within our Large Trader System and to maximize the scope of our regulatory authority. In fact, we recently lowered accountability levels in our metals and core energy contracts and expanded the scrutiny we apply to a participant's position on a futures only basis as well as a futures equivalent basis.

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[6] Commission Regulation 150.5 addresses position limits and accountability limits. In relevant part, Commission Regulation 150.5 provides:

> For futures and option contracts on a tangible commodity, including but not limited to metals, energy products, or international soft agricultural products, having an average month-end open interest of 50,000 contracts and an average daily volume of 5,000 contracts and a liquid cash market, an exchange bylaw, regulation or resolution requiring traders to provide information about their position upon request by the exchange and to consent to halt increasing further a trader's positions if so ordered by the exchange, *provided, however,* such contract markets are not exempt from the requirement of paragraphs (b) or (c) that they adopt an exchange bylaw, regulation or resolution setting a spot month speculative position limit with a level no grater than one quarter of the estimated spot month deliverable supply;

[7] Exchange Market Regulation staff has drafted rules that would allow an Exchange's Chief Regulatory Officer additional flexibility to order a reduction of positions above accountability levels or above position limits (pursuant to a hedge exemption) at his discretion.

Moreover, we create and maintain a weekly report of all participants that exceed COMEX Position Accountability Levels in all core contracts, through which analysts and Market Surveillance management make real time decisions on actions to be taken respecting market participants' positions. Between January 2009 and February 2010, we took 28 such actions to maintain or reduce market participants' positions. Additionally, the Surveillance staff monitors deliverable supplies in order to anticipate potential congestion or delivery problems.

An exemption from exchange set position limits can be granted by the exchange for bona fide hedgers based on physical or swap exposure. Firms wishing to exceed the position limits for the purpose of establishing a hedge of a physical or swap market position must file a hedge notice and obtain the approval of the Exchange. The applicant must document that the positions to be held are bona fide hedge positions by providing the company's current, historical, or anticipated exposure in the physical or swap markets, as well as any supplemental information the exchange may require.

In granting hedge exemptions the exchange considers the following criteria: 1) hedge or swap exposure; 2) financial condition and stability of the company; 3) market liquidity; 4) trading history of the company; and 5) internal procedures and controls suitable to oversee the position. The exchange may elect to revoke the hedge exemption in the event the company is unable to meet the above requirements, or if market factors change. Firms exceeding the limits that are unable to demonstrate physical or derivative exposure are in violation of position limit rules and subject themselves and possibly their clearing firms to disciplinary action.

A hard copy summary sheet of all exemptions is regularly and routinely filed with CFTC's DMO in New York. This procedure has been in place for many years. Moreover, CFTC Rule Enforcement Reviews have included PAL inquiries and have affirmatively concluded that when accountability levels are reached, COMEX responds promptly, almost always on the same day, by contacting the customer to obtain required information and take appropriate additional action when warranted.

The current framework with respect to position limits and exemption therefrom established by the CEA and currently implemented by the Commission and the exchanges is working. Therefore, it is unnecessary for the Commission to impose position limits across all markets and participants, including swap dealers, index funds and managers of ETFs, without the possibility of exemptions. The Commission should continue to allow each exchange, subject to Commission oversight of its compliance with DCM Core Principles, to establish rules consistent with the objectives of reducing the potential threat of market manipulation or problems arising from excessively large speculative positions.

Question four asks whether, "such limits enhance market integrity and efficiency?" It is not clear what is meant by "such limits," however, based on the flow of the questions, "such limits" seems to be a reference to the world-wide limits set on speculators by a single agency or by means of coordination among world regulators. Since there is no demonstrable need for such limits, it is certain that it will not happen. It is highly unlikely that London and China would adopt limits to placate a few gold and silver traders who do not understand the dynamics of the

global markets that govern the supply and demand, and consequently the pricing, for various metals. Without the cooperation of these markets, any efforts to attain this goal would be futile.

If, however, the question is whether limits imposed by the CFTC under its current authority – or even the expanded authority proposed in pending legislation – would enhance market integrity and efficiency the answer is clearly no. Federally prescribed position limits imposed on derivative traders in the metals in the U.S. will have one and only one consequence: a loss of business to U.S. companies. Firms large enough to run up against those limits will transfer their positions to the cash market or to markets beyond the reach of the CFTC. As previously noted, this is already happening, solely based on the *fear* that limits will be imposed. We fail to understand how any policy that moves trading off of regulated markets can contribute to efficiency or integrity.

In its original set of questions for today's meeting, the Commission had asked whether, "it needed additional authority to accomplish these goals?" Setting limits, no matter how comprehensive, is not a goal. Rather, the goal must be fair and efficient markets and the U.S. futures markets for metals are operating effectively and efficiently under the current regime in which the exchanges take responsibility for controlling positions that might cause congestion or price distortion.

We do not believe that the Commission has power to set position limits unless it is acting in strict compliance with the explicit limitations in the CEA. Section 4a(a) of the CEA authorizes the Commission to impose daily trading limits and speculative position limits if "*necessary* to diminish, eliminate or prevent" the burdens of "excessive speculation."[8] The statute loosely defines "excessive speculation" as that which causes "sudden or unreasonable fluctuations or unwarranted changes" in the price of a regulated futures contract.[9] Thus, Section 4a(a) requires the Commission to find that (i) there is in fact "excessive speculation" or that it is likely to occur in the metals and (ii) position limits are "necessary" and will, diminish, eliminate or prevent the burdens of such speculation before it may impose position limits. No such findings have been made here, therefore imposing limits would exceed the Commission's statutory authority.

In addition to exceeding the Commission's explicit statutory authority, imposing such limits in the metals diverges from the existing regulatory regime respecting position limits established by the Commission decades ago based on its reading of the CEA. To be sure, pursuant to its authority under CEA Section 4a(a), the Commission historically has set speculative position limits for enumerated agricultural commodities. With respect to all other commodities, however, the Commission has delegated the authority to set position limits to designated contract markets.

As our CEO, Craig Donohue, testified before the Commission in July 2009:

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[8] 7 U.S.C. §6a(a).

[9] *Id.*

> This delegation of authority took place in 1981 when the Commission adopted former Regulation 1.61, which required exchanges to impose speculative position limits. In setting forth its reasoning for requiring exchanges to take such action, the Commission emphasized that Section 4a(a) "should not be read in a vacuum," explaining that when the CEA "is read as a whole, it is apparent that Congress envisioned cooperative efforts between the self-regulatory organizations and the Commission. Thus, the exchanges, as well as the Commission, have a continuing responsibility in this matter under the Act." The Commission went on to note that former Regulation 1.61 "merely effectuates completion of a regulatory philosophy the industry and the Commission appear to share," referencing the fact that the exchanges had already been imposing position limits on certain contracts.
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> To ensure that no doubt remained as to the exchanges' role with respect to speculative position limits, the Commission further explained that CEA Section 8a(7) "underscores the fact that Congress affirmatively contemplated a regulatory system whereby the exchanges would act in the first instance to adopt rules which would protect persons producing, handling, processing or consuming any commodity traded for future delivery." Consistent with this approach, the Commission fashioned former Regulation 1.61 to assure that the exchanges would have an opportunity to employ their knowledge of their individual contracts to propose the position limits they believe most appropriate.
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> With the adoption of former Regulation 1.61, the regulatory structure for speculative position limits was administered under a two-pronged framework, resulting in enforcement of speculative position limits being shared by both the Commission and the DCMs.

The exchanges' authority and responsibility to set position limits in the first instance with respect to the non-enumerated agricultural commodities under the CEA could not be clearer. If, however, the Commission makes a finding — after due notice and opportunity for a hearing — that there is "excessive speculation" (as defined in CEA Section 4a(a)) with respect any metals contract, the Commission may request that exchanges make necessary changes to their rules and impose speculative limits. Should an exchange fail to make the requested changes, we believe that the Commission has authority under the CEA to impose position limits directly (assuming, again, that it makes the requisite findings under Section 4a(a)).

To the extent that the Commission intends to impose position limits in the OTC markets, we do not believe that it currently has authority to do so. CEA Section 4a(a) only applies to "contracts of sale of such commodity for future delivery on or subject to the rules of any contract market or derivatives transaction execution facility."[10] We are not aware of any other law that grants the Commission authority to regulate futures markets or contracts through use of federally mandated position limits.

[10] 7 U.S.C. §6a(a).

Question five asks, "if the Commission were to establish position limits for metals markets,

a) What formulation should be used to determine position limit levels for each market?
b) What quantitative measures should be used in setting limits on the size of an individual trader's position?
c) Should limits be established by percentage or proportion of the market or by fixed number of allowed contracts?
d) Should limits apply in all months combined, in individual months, and in the delivery month?
e) Should spread trades be incorporated in this calculation?
f) Should the Commission limit the aggregate amount of positions held by one trader across different markets?
g) What metal commodities should be covered?"

We do not believe that the Commission can or should impose position limits in the metals for the reasons discussed above. Therefore, we do not have a recommendation at this time as to the factors, formula or parameters the Commission should consider in calculating any position limits in the metals. However, if the Commission were to make findings pursuant to 4a(a) with respect to metals and issue a notice of proposed rulemaking to take action to address such findings, CME Group certainly would analyze the foregoing question at that time and offer its views in a responsive comment letter.

Relatedly, question six asks "if the Commission were to establish position limits for metals markets, what types of exemptions from such limits should be permitted?

a) The statute states exemptions should only be granted to bona fide hedgers. What should be the qualifying factors for an entity to be determined to be a bona fide hedger?
b) In granting exemptions, should the Commission consider the nature of an intermediary's counterparties (e.g., should the Commission consider "looking through" a swap dealer's or index trader's position to its counterparties)?"

Because we do not believe that it is rational for the Commission to set position limits for metals markets, we cannot adequately describe the type of exemptions that should be permitted at this time. As previously noted, COMEX and the other CME Group Exchanges manage exemptions on a day-to-day basis to avoid congestion and price distortion. Exemptions are market specific, fact intensive inquiries for which COMEX is uniquely qualified to make a determination. However, if the Commission were to make findings pursuant to 4a(a) with respect to metals and issue a notice of proposed rulemaking to take action to address such findings, CME Group certainly would analyze the foregoing questions at that time and offer its views in a responsive comment letter.