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May 15, 2020

Christopher Kirkpatrick, Secretary of the Commission
U.S. Commodity Futures Trading Commission
1155 21st Street NW
Washington, DC 20581

Re: Position Limits for Derivatives, RIN 3038–AD99

Dear Secretary Kirkpatrick,

On behalf of Public Citizen's more than 500,000 members and supporters across the United States, I offer these comments on the proposed position limits rule. Public Citizen is a national, not-for-profit, non-partisan research and advocacy organization representing the interests of household consumers. I also serve as a voting member of the Commission's Energy and Environmental Markets Advisory Committee, as well as serving on the Commission's Market Risk Advisory Committee.

The Commission's Position Limits proposal will ineffectively control excessive speculation because it unnecessarily expands hedge exemptions and grants leeway to financially-conflicted for-profit exchanges to determine such exemptions. The impact is to dilute the effectiveness of the position limits, exposing consumers to prices driven more by excessive speculation and market position concentration. The proposed rule fails to take into account lessons learned from recent turbulence in oil markets, and should require more expanded public data reporting. The rule should be revised to address these shortcomings.

Section 737 of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* directs 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."[1] Effective position limits reduce excessive levels of speculation and restrict the ability of traders from dominating a market. Household consumers benefit from fairer prices reflecting actual supply and demand when strong position limits are employed.

[1] Public Law No. 111-203, www.congress.gov/111/plaws/publ203/PLAW-111publ203.pdf

Unfortunately, the proposed rule fails to establish such effective position limits, particularly due to the delegation of Commodity Exchange Act authorities to for-profit corporations. As Commissioner Dan M. Berkovitz declares in his *Dissenting Statement*:

> *The Proposal would create an uncertain and unwieldy process with the Commission demoted from head coach over the hedge exemption process to Monday-morning quarterback for exchange determinations. The Proposal would abruptly increase position limits in many physical delivery agricultural, metals, and energy commodities, in some instances to multiples of their current levels. It would provide no opportunity for the Commission to monitor the effect of these increases, or to act if necessary to preserve market integrity . . . The Proposal also ignores Congress's mandate in the Dodd-Frank Act . . . It would require, for the first time, the Commission to find that position limits are necessary for each commodity prior to imposing limits . . . Unless substantially modified in the final rulemaking, it will likely doom this regulation as "arbitrary, capricious, or an abuse of discretion'*[2]

## I. The Commission Should Not Delegate Authority To For-Profit Exchanges To Grant Exemptions From Position Limits

Of particular concern is the Commission's new, industry-friendly procedures for securing exemptions from the position limits for non-enumerated bona fide hedges. The proposal grants authority to the for-profit exchanges to provide exemptions from position limits with just a single application from a market participant. While the proposal does reserve the right to the CFTC to object within 10 business days, it places the for-profit exchanges in the drivers' seat of making the decisions on granting exemptions.

Two for-profit corporations—CME Group, Inc. and Intercontinental Exchange, Inc.—dominate the commodity clearinghouse market. Historically, clearinghouses were not-for-profit or member-owned associations. But in the last two decades, a combination of deregulation and organizational changes shifted the exchange structure to for-profit corporations.

As I stated in a formal dissent report to the CFTC Energy and Environmental Markets Advisory Committee in February 2016,[3] this shift to exchanges operating as for-profit corporations has transformed their operational goals. There are three primary methods CME and ICE derive profit: clearing and transaction fees based upon trading volume; 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 greater the profit-making opportunities for the exchanges. Conversely, lower trading volume constricts profit-

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[2] Appendix 6, Federal Register, Vol. 85, No. 39, February 27, 2020, www.govinfo.gov/content/pkg/FR-2020-02-27/pdf/2020-02320.pdf

[3] www.citizen.org/documents/dissent-report-CFTC-february-2016.pdf

making opportunities. CME annual reports to the Securities and Exchange Commission describe 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.[4] The *Financial Times* reported that CME offered a bonus of as much as $1 million per month to the largest traders for one of its crude futures products.[5] Such volume bonuses undermine efforts for an exchange to determine hedge exemptions for position limits.

Profiting off of promoting higher trading volume directly interferes with the exchange's proposed function here as the decision-maker on granting exemptions to position limits. While the exchanges maintain that they feature internal firewalls, the integrity of those firewalls are suspect.

Indeed, both CME and ICE have difficulty cooperating with current laws and regulations, casting doubt on their ability to independently enforce the proposed rule. 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."[6]

The Commission is currently in federal court accusing CME of violating internal firewalls and selling confidential trading information to an outside broker.[7] Considering that a CFTC federal lawsuit against CME remains active, the Commission should not be handing CME any additional authority until the allegations in court are resolved. These transgressions by both ICE and CME inspire little confidence that for-profit exchanges can be trusted to enforce critical components of congressional mandates.

## II. The Proposal Fails To Address Flaws Exposed By Recent Market Turmoil

The Commission's position limits proposal neglects to address commodity markets' shortcomings exposed during the recent COVID 19-spurred upheaval in oil contracts. As a key oil benchmark contract neared its expiry, the market experienced massive volatility—swinging in price by $55 in one day—as prices went below zero for the first time in history. The reason? The speculators driving the market panicked as they realized that the contract technically could require settlement in the form of physical delivery, and all of the storage was full:

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[4] At page 30, www.sec.gov/ix?doc=/Archives/edgar/data/1156375/000115637520000013/cme-2019123110k.htm

[5] Ajay Makan & Gregory Meyer, "CME under fire over cash for trades in Brent," August 18, 2013.

[6] www.cftc.gov/PressRoom/PressReleases/pr7136-15

[7] *U.S. Commodity Futures Trading Commission v. Byrnes et al*, Case # 13-cv-01174, U.S. District Court, Southern District of New York. See also www.cftc.gov/PressRoom/PressReleases/6519-13

*As the May expiry rolled around, all the financial buyers wanted out, but none of the refiners wanted any more oil—because, again, the world economy has stopped—and so the financial traders had to pay someone quite a bit of money to take the oil off their hands . . . Financial speculators have purchased too much virtual oil and are rushing not to actually get it . . . you'd expect an efficient market to figure out the storage problems more than one day ahead of expiry, and unwind contracts in a more orderly way.*[8]

Indeed, the turmoil has prompted a stern letter from Chairman Heath P. Tarbert reminding exchanges of their basic responsibilities.[9] The markets are not operating efficiently, in part because of the outsized role speculators continue to play. And the position limits proposal fail to address the issue.

The problem has been exacerbated by the for-profit exchanges' tacit cheerleading of retail investors' involvement in the market—such as exchange-traded funds—that manufacture more demand and trading volatility than otherwise would be present in the market.

## III. In Markets, Information Is King, But The Public Lacks Access To Data Necessary To Properly Evaluate Position Limits

The proposal's flaws are further complicated by the fact that there is so little public disclosure of critical market data:

*Recent turbulence in the price of light sweet crude oil futures has highlighted how little is known about the positions of traders and their impact on the formation of prices . . . Researchers still cannot reconstruct trading activity and its impact on futures prices around the oil price spike in 2008 or the flash crashes of 2010 and 2012 . . . There is a strong case for increasing the amount of data published on historical positions, after a suitable delay . . . the public interest in better understanding how futures markets work and the impact on prices faced by producers and consumers outweighs confidentiality concerns . . . Futures markets provide public as well as private functions, which is why they have a special legal and regulatory status that sets them apart from other commercial marketplaces.*[10]

The proposed rule on position limits is tone-deaf to the serious problems and inefficiencies we are seeing today in commodity derivative markets. The Commission needs to significantly modify this flawed rule, and enact strong position limits without a decision-making role for the for-profit exchanges, and require more public data reporting to allow independent researchers an opportunity to better understand the role speculation plays in aggravating market inefficiencies.

[8] https://twitter.com/TysonSlocum/status/1254783664262545408
[9] CFTC Letter No. 20-17, May 13, 2020, www.cftc.gov/csl/20-17/download
[10] https://twitter.com/TysonSlocum/status/1256229782905380867

Respectfully submitted,

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