Nguyen, Trangkieu

From: questions
Sent: Tuesday, January 18, 2011 3:13 PM
To: PosLimits
Subject: FW: Position limits

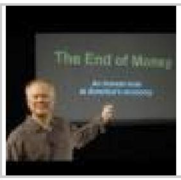
From: Jim Loudon [mailto:jimwloudon@yahoo.com]
Sent: Saturday, January 15, 2011 7:34 PM
To: questions
Subject: Position limits

<u>I am writing to tell you how disappointed I am that you will not enforce the law on position limits.</u> It is now very clear to me that you are controlled by JP Morgan and other large banks and care nothing about the common investor. I will now work diligently to see that a new regulator agency is set up to replace you.
The common man now knows who you work for as clearly outlined in this article.
Shame on you!

JP Morgan Wins: CFTC Position Limits Do Not Apply (To Them)

Email

Friday, January 14, 2011, 12:17 pm, by cmartenson



Speaking of changing the rules...

Gold and silver are now down hard over the past two days, and the reason may have something to do with the fact that the CFTC utterly caved to JPM in their long-awaited decision on position limits in a 4-1 vote.

While position limits will eventually be set, maybe, someday, the course of action taken by the CFTC grandfathers in JPM's (and HSBC, et al.) current outlandish positions.

Here's the background (**emphasis** *mine*):

> On July 21, 2010, the Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act. Among other things, the Dodd-Frank Act amended the Commodity Exchange Act to:
>
> - **Require the Commission**, as appropriate, **to limit the amount of positions**, *other than bona fide hedge positions*, that may be held by any person with respect to commodity futures and option contracts in exempt and agricultural commodities traded on or subject to the rules of a designated contract market (DCM).
> - Require the Commission to establish position limits, **including aggregate position limits**, for swaps that are economically equivalent to DCM contracts in exempt and agricultural commodities (collectively, economically equivalent swaps). Such limits must be imposed simultaneously with limits on DCM contracts.
>
> (**Source**)

The only wiggle room in the Dodd-Frank bill is for "bona fide" hedge positions, which, I should state, I think is not a good idea because the exact definition of a 'bona fide hedge' is elusive.

For example, you and I could decide to engage in a massive short-hedged position where you short a commodity but buy calls from me. Your 'hedge' is only as good as my credit. Or perhaps you decide that oil and natural gas have enough negative correlation that you are 'hedged' by being equally short and long on both substances. What if your correlation blows out? You're not hedged, is the answer to that question.

Continuing into the meat of the new position limit ruling, we find these discomforting items:

> The Commission's proposed regulations call for:
>
> Position limits to be placed on 28 core physical-delivery contracts and their "economically equivalent" derivatives.
>
> Establishment of position limits on physical commodity derivatives in **two phases**:
> - **Initial transitional phase: spot-month position limits only, based on deliverable supply**determined by and levels currently set by DCMs.
> - Second phase: spot-month position limits, based on the Commission's determination of deliverable supply, and position limits outside of the spot month.

Translation: Only the front month of any contract will be subject to the position limits initially. Later, at some undefined point "early next year," out months will be included. But for now it's just the spot month.
Impact: Watch out for crazy out-month behaviors as JPM, et al. seek to skirt this rule.
Okay, that's not too terrible.

But this is:

> Spot-month position **limit levels set at 25% of deliverable supply** for a given commodity, with a conditional spot month limit of **five times that amount for entities with positions exclusively in cash-settled contracts**

That's just horrible.

For anybody like JPM that has no intent of taking physical delivery, they will be prevented from accumulating a position that is more than 125% of the total deliverable supply. What sort of a limit is that?? That's like trying to limit the damage from auto accidents by 'limiting' freeway speeds to 'no more than' 175 mph.

Also, anybody who might want to actually buy the physical is limited to 25%, so any potential Hunt Bros. need not apply. The outer limits of this game have been exclusively reserved for speculators and manipulators.

That's not even remotely the outcome I was hoping for. This 'ruling' tantamount to saying "carry on!"

And what does 'deliverable supply' mean? Does it refer to COMEX warehouse deliverables in current storage or can special players receive additional preferential treatment by including 'deliverables' available to them via contractual arrangements with the LBMA? Lots of questions are emerging for me here.

But it gets worse:

> **Exemptions for bona fide hedging transaction**s (based on the Dodd-Frank Act's new requirements for such transactions) **and for positions that are established in good faith prior to the effective date of specific limits adopted pursuant to the proposed regulations.**

Translation: "*JPMs silver position is in complete violation of even these generous new 'rules' so we're just going to let them keep it.*"

Impact: Just check the price behavior of gold and silver for the impact. The gold and silver markets have traded upwards of late in part because of the thought that JPM would finally be forced to play fair and reduce their outlandish precious metals short positions. Nope. Guess not.
Once again, all sense of fair play has been abandoned in the interest of giving a special handout to a set of large banks that are reporting near-record earnings. When, I must ask, is enough *enough*?
The message that I receive from this ruling is that US markets are now hopelessly and irrevocably captive to the behind-the-scenes wishes of the banking class, for which "everything and then some" seems to be not quite enough.

Worse, an already-battered faith in the markets has been kicked again.

Here's my prediction: Someday the US commodities markets will experience a very painful set of failures, big banks will be caught on the bad end of that experience, and they will simply, once again, lobby to have the rules changed in their favor.

To everybody who hopes to make money by being on the opposite side of that trade, good luck collecting your winnings. They will simply be rule-changed right out of your hot little hands.

Thank you for playing sir, and sorry about your luck; would you care to try again?
The CFTC is now playing the role of Lucy holding the football. If you don't wish to be the Charlie Brown in this story, I'd advise that you take delivery.

Here's CFTC Chairman Gary Gensler describing the rationale, such as it is, for the CFTC's ruling [with **my reactions** inserted in-line]:

> Position limits help to protect the markets both in times of clear skies and when there is a storm on the horizon. In 1981, the Commission said that "the capacity of any contract market to absorb the establishment and liquidation of large speculative positions in an orderly manner is related to the relative size of such positions, i.e., the capacity of the market is not unlimited." [**So far, so good!**]
> Today's proposal would implement important new authorities in the Dodd-Frank Act to prevent excessive speculation and manipulation in the derivatives markets. The Dodd-Frank Act expanded the scope of the Commission's mandate to set position limits to include certain swaps. **[Still good]**
> The proposal re-establishes position limits in agriculture, energy and metals markets. It includes one position limits regime for the spot month and another regime for single-month and all-months combined limits. It would implement spot-month limits, which are currently set in agriculture, energy and metals markets, sooner than the single-month or all-months-combined limits. **[Okay, spot-month goes first, before single-month and all-months combined. Got that. With the grandfather and 'bona fide hedge' exemptions of course. Left that part out...]**
> Single-month and all-months-combined limits, which currently are only set for certain agricultural contracts, would be re-established in the energy and metals markets and be extended to certain swaps. These limits will be set using the formula proposed today based upon data on the total size of the swaps and futures market collected through the position reporting rule the Commission hopes to finalize early next year. **["*Will be* set?" Early next year? Isn't that a year from now? Why so long?]**
> It will be some time before position limits for single-month and all-months-combined can be fully implemented. In the interim, if a trader has a position that is above a level of 10 and 2 ½ percent of futures and options on futures open interest in the 28 contracts for which the Commission is proposing position limits, I have directed staff to collect information, including using special call authority when appropriate, to monitor these large positions. **[For silver, this amounts to some 5,300 contracts. Well above the 1,500 contracts Ted Butler called for based on the 1% of world production limit. It's too high.]**

> Staff will brief the Commission and make any appropriate recommendations based upon existing authorities for the Commission's consideration during its closed surveillance meetings at least monthly on what staff finds. **[Oh, so this is not a regulatory action, but a fact-finding mission? It's rather unusual to find a government body that takes care to under-interpret a congressional mandate for regulatory power, but we seem to have one in the CFTC. Odd that such a loss of regulatory nerve only seems to occur when the interests of big banks are on the line...]**
> (**Source**)

Let's close with a statement of regret by Bart Chilton, who tried very hard to do the right thing, but couldn't get the other four commissioners to see things his (and my/our) way.

> Statement of Commissioner Bart Chilton at the 9th CFTC Public Meeting on Rulemaking under the Wall Street Reform and Consumer Protection Act
>
> January 13, 2011
>
> As regulators, I think we have one key mission. It is embodied in the Commodity Exchange Act. We have a singularity of purpose to ensure efficient and effective markets and to prevent and deter fraud, abuse and manipulation. Quite frankly, I think we can do better. We can because the new Wall Street Reform and Consumer Protection Act requires that we develop what many of us consider to be some fairly precious parameters.
>
> Today, I am hopeful we will move forward to propose a position limits rule, a most precious parameter that we should have proposed much earlier in a way that would have implemented the provision as Congress intended. That's not happening.
>
> **Yesterday, eight U. S. Senators told us to move forward on limits. That follows two other senatorial letters from last month.**
> **This is a Commission of five individuals, a group of people who make these decisions. That pretty much ensures no individual will get their way all the time. I'm certainly not getting my way on position limits, nor are the Senators who wrote to us.**
>
> I am thankful that we will have position points in place as a kind of glide path to position limits. As I've said repeatedly, points are not limits. However, they will help us learn more and do better as we go forward in further developing important—and precious— parameters.
>
> (**Source**)

Thank you for trying Bart. I am grateful for your efforts. I wanted to give Gary Gensler, the former Goldman Sachs executive, the benefit of the doubt, and I did that. All benefit and all doubt now removed. Once a squid, always a squid, I guess.

I am still trying to get my arms around this ruling and its likely impact on gold and silver prices going forward. Long-term this changes nothing, except to reinforce my conviction that I have no interest in playing in rigged markets.

Further, given the opportunity to do the right thing in an open and transparent manner, the CFTC, quite predictably, caved to large interests - the same large interests that are helping to shape, if not drive, current fiscal and monetary policy.

For more on rule changing, please read yesterday's piece, **Don't Worry, They'll Just Change the Rules**. I guess I should append the following to that title "*...or decline to enforce them*."