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COMMENT

secretary

From: Ravi Etwaroo [ravi.etwaroo@gmail.com]
Sent: Wednesday, November 05, 2008 11:04 AM
To: secretary
Subject: Proposed Rules for Trading Off the Centralized Market

To whom it may concern:

I am a market maker in the Cotton Options Pit on the ICE exchange. I have been trading for several years, and have traded everything from currencies, energies, metals and agricultural products. In the past few years I have noticed some very alarming trends, primarily the growth of off-exchange trading and now "block" trading. What has happened recently in the financial world should make it evident of the dangers posed by both.

The commodity industry can not handle these transactions on any scale, they are quite poisonous to the health of the marketplace.

My experience as a Cotton trader has made this all the more obvious to me. Your commission is still investigating what happened in this market (as highlighted in The Wall Street Journal , but it has not realized what the effect off-exchange trading has also done to the long term trading in cotton. The market really is "broken".

The problems that the financial markets have been enduring the last few months stem from the use of OTC, non-competitively priced trades in MBS's. While counter-party risk is a big component of what triggered the panic, the lack of transparency and the size of trades off-exchange are major factors in the dramatic and volatile movements that we have seen and endured lately.

Markets need to grow organically. Centralized trading on exchange with a competitive trading structure allows hedging, transparency, and an increase in retail volume, which is often the catalyst to long-term growth. We cannot let a few banks dictate what is in the best interests of the exchanges, as banks are far too often driven by quarterly profits and unscrupulous practices made all too evident recently.

Our commodity exchanges have existed for centuries based on the free-market notions that everyone is allowed a fair price and given an opportunity to participate in whatever transactions they deem necessary for their hedging/producing/trading strategies. By allowing off-exchange, non-competitive transactions to be cleared through the exchanges, we will watch the eventual demise of the US commodity exchanges as a marketplace. End user demand and producer hedging are what made the commodities markets grow and innovate in the first place.

Non-transparent transactions are the source of our current economic crisis. When specialists in a field are allowed to assess and price a financial product, be it a stock option, commodity future, or mortgage-backed bond...fair value is reached and every concerned participant, whether it be a retail bank, a farmer or a refiner can see and react accordingly.

Off-exchange transactions also have a nasty habit of rearing their heads at the most inopportune times, and as we have seen in so many financial products lately, force bankruptcies and liquidations. These liquidations and panics leave some participants much wealthier, some bankrupt, and everyone else disgusted and disappointed in what happened.

Our commodity markets can not afford this sort of binge and purge approach to trading. We are facing deep liquidity issues that cause massive price fluctuations and volatility. This in effect drives away business for a very long time. The flight to liquidity is the primary reason why the Treasury and currency markets have such high volumes. Requiring participants to enter into the market also generates the run-on effect of risk dispersion.

Having market-makers on exchanges trade these products drives up activity further along the term structure*, and introduces more transactions to the marketplace. Market makers and retail customers also create products and further along financial innovation. This is imperative at a time like this.

The hedging principal works in this scenario as well because every day traders are forced to mark to market, and therefore have to hedge accordingly. OTC trades on the other hand, have escaped the rigor of market pricing, and this is often to the detriment of one of the parties. This party usually finds out when they are forced to cover their positions in the open market.

*Market makers and other product specialists have been shown to increase the depth of markets along the term-structure. When markets grow opaque through OTC block trading, the pricing mechanisms that determine fair value no longer exist, and trade participants have a hard time laying off risk and hedging crops/yields into the next 6-12 months, or further back 1-3 yrs.

At this critical juncture in our financial history, we cannot afford to lose our competitiveness in the world marketplace. It is in my opinion that the more transactions that can be brought onto the marketplace and traded competitively, the healthier our markets will be. If these damaging panics and bubbles continue we will eventually lose ground to the Asian commodity exchanges, and this will cause us to lose our status as the primary trading hub for commodities. The risks to our financial AND our agricultural community is great, and the amount of tax revenue lost will be massive. These shortsighted policies will be the primary cause of this.

Sincerely,
Ravi Etwaroo