



**MARYKNOLL OFFICE FOR GLOBAL CONCERNS**  
*Peace, Social Justice and Integrity of Creation*  
[www.maryknollogc.org](http://www.maryknollogc.org)

April 23, 2010

David Stawick, Secretary  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21st Street, NW.  
Washington, DC 20581  
[secretary@cftc.gov](mailto:secretary@cftc.gov)

Submission from the **Maryknoll Office for Global Concerns** for  
“Federal Speculative Position Limits for Referenced Energy Contracts and Associated  
Regulations” (Federal Register / Vol. 75, No. 16 / Tuesday, January 26, 2010 / Proposed  
Rules / pages 4144-4172).

The Maryknoll Office for Global Concerns (Maryknoll OGC) applauds the Commission for moving to limit speculation in energy commodity futures as excessive speculation has clearly disrupted the smooth functioning of the futures markets in recent years. While the Proposed Rule is a good first step, we believe that other steps must be taken to guarantee that commodity markets function without undue influence from speculators.

We represent Maryknoll, a Catholic missionary organization with missionaries in Asia, Africa and Latin America. Our missionaries see first hand the dramatic effects of volatile food and energy prices on those who live in precarious conditions in marginalized communities around the world. The UN estimated that an additional 130 million people were driven to hunger by the energy and food commodity bubbles of 2008, pushing the total number to more than one billion people unable to guarantee food for themselves. Food riots exploded in dozens of countries around the world and untold thousands died of starvation. Our missionaries personally know many, many people who were driven to desperation.

***Maryknoll Sisters • Maryknoll Fathers & Brothers • Maryknoll Lay Missioners***

P.O. Box 29132  
Washington, D.C. 20017  
(202)832-1780 phone  
(202)832-5195 fax  
[ogc@maryknoll.org](mailto:ogc@maryknoll.org)

P.O. Box 311  
Maryknoll, N.Y. 10545  
(914)941-7575 phone  
(914)923-0733 fax

777 First Avenue, 10<sup>th</sup> fl.  
New York, N.Y. 10115  
(212)973-9551 phone

Considering how difficult *normal* living conditions are in many of those countries where chronic hunger is a reality, the fact that people all around the world were driven to riot because of increased hunger should make all CFTC commissioners pause to reflect. Think of how many children cried themselves to sleep at night while their parents listened in desperate agony unable to do anything to help. The year 2008 was a horribly bleak year for many millions of people around the world. The CFTC must do everything it can to help avoid such bubbles and undue influence from speculators in the future.

Commodities are the lifeblood of the entire global economy, the root of everything that is consumed, including food, the basis of life itself. In order to distribute commodities throughout the economy most efficiently, their prices should be determined on the basis of conditions of supply and demand of each product. That is why, beginning with the Commodity Exchange Act of 1936, Congress established common sense rules in the futures markets to allow producers and consumers of physical commodities to hedge safely. For a number of essential food commodities, Congress defined speculative position limits in order to allow traditional speculators to provide liquidity to the markets while assuring that they would not have undue influence on the determined prices.

This system functioned fairly smoothly for many decades, but in the last 25 years, a series of missteps taken by the CFTC and Congress have resulted in commodity futures markets where prices are not only determined by the supply and demand of physical commodities, but also by the whims of institutional investors.

Perhaps the beginning of the slippery slope was in 1986 when Congress asked the CFTC to expand exemptions from speculation limits, which had traditionally been applied to commercial firms hedging to physical holdings of a commodity, to traders such as swap dealers who were using the futures market to hedge their exposure to financial instruments rather than actual physical commodities. In 1991, the CFTC granted the first exemption from its speculative position limits to a swap dealer seeking to hedge its exposure to a commodity index swap which it had sold to a pension fund. Since then the CFTC has granted a number of hedge exemptions to swaps dealers. In addition, the CFTC has written “No-action” letters for exchange traded funds allowing them to surpass speculation position limits that others must adhere to. Finally, in 2004, the SEC permitted the first commodity index funds, that we consider to be especially destructive.<sup>1</sup>

These decisions led to the “financialization” of the commodity markets which we consider to be central cause of the otherwise unexplainably volatile commodity prices. In February 2010, Donald Tsur, CEO of Psagot Compass Investments, stated that, “In 1995, for each actual barrel of crude that changed hands each day seven virtual barrels were traded. Trade in the oil futures market was eight times the daily consumption of oil, by volume. That figure has continued to increase, rising to 1:10 in 1999, 1:13 in 2004, 1:25 in 2006 and to a stunning level of 1:38 today.”<sup>2</sup> We believe that commodity markets should be dominated by bona fide end users with some limited speculation for liquidity.

---

<sup>1</sup> Excessive Speculation in the Wheat Market, Majority and Minority Staff Report, Permanent Subcommittee on Investigations, U.S. Senate, June 24, 2009, Pgs. 106-109

<sup>2</sup> Speculative tsunami alert, Fe. 3, 2010 <http://www.haaretz.com/hasen/spages/1146934.html>

These ratios of real to virtual trading are not acceptable. The commodity markets have become yet another financial tool for investors instead of a mechanism for producers and consumers to hedge and for price discovery. We cannot allow markets that are so essential for life itself and the foundation of the entire global economy to be unduly influenced by speculators.

### **Passive Investments/ Commodity Indexes and EFTs**

Maryknoll OGC thinks that allowing participants into commodity markets who base their investment decisions on anything other than the supply and demand fundamentals for a specific commodity is a fatal flaw that must be reversed. Every dollar invested in commodity markets based on any logic other than supply and demand results in damaging the price discovery function of those markets. Commodity indexes and ETFs represent hundreds of billions of dollars being invested, not based on supply and demand fundamentals, but on portfolio asset allocation. We believe, therefore, that they should be banned from commodity markets as they bring no benefits to those markets while seriously undermining their functioning.

Passive investments in commodities have grown rapidly in the past few years. Christopher Johnson of Reuters reported that “Pension funds and money managers have tripled their holdings in commodities markets since 2007, industry data show, with \$250bn to \$300bn now invested by passive long-only funds.”<sup>3</sup>

According to testimony from Michael Masters to the Commission on March 25, 2010, “In 1998, the average commodity derivatives market was about 25% speculative as a percentage of open interest. By 2008, speculators comprised about 65% of open interest. Bona fide physical hedgers once outnumbered speculators 3 to 1; now speculators outnumber hedgers 2 to 1. The positions of bona fide physical hedgers doubled during this ten-year period, while the positions of speculators rose by 1200%.”<sup>4</sup>

As part of its study of speculation in wheat markets, the Senate’s permanent subcommittee on investigations interviewed a large number of farmers, grain elevator operators, and grain market analysts. “Virtually all of the grain traders and many of the market analysts provided the Subcommittee with the same explanation for the large, persistent difference in Chicago wheat futures and cash prices (basis), and for the failure of those prices to converge as the futures contracts near expiration. These grain traders and analysts stated that the most significant factor contributing to the increasing basis and the lack of price convergence was the large presence of commodity index traders in the Chicago wheat futures market. Many traders stated that index traders had created an additional demand for futures contracts that was not related to or matched by any corresponding demand in the cash market, and that the futures prices had responded to this added demand by rising to a higher level than the prices in the cash market.”<sup>5</sup>

---

<sup>3</sup> Commodities bubble likely, analyst says, Feb 5, 2010

<http://www.nationalpost.com/related/links/story.html?id=2524046>

<sup>4</sup> from testimony by Michael Masters to the CFTC, March 25, 2010

<sup>5</sup> Excessive Speculation in the Wheat Market, Majority and Minority Staff Report, Permanent Subcommittee on Investigations, U.S. Senate, June 24, 2009, pg. 138

It is especially urgent to act quickly to rein in passive investments as many institutional investors are increasing their commodity holdings, thus increasing the danger of unduly influencing prices even more. “Even after a year of record commodity investment in 2009, institutional investors are prepared to increase investment in the asset class to new record levels in 2010, according to a survey of more than 300 attendees at a conference hosted by Barclays Capital... nearly 60% of survey respondents indicated they increased their commodity exposure over the past 12 months. And despite the sizable inflows this year, 63% of those surveyed indicated they plan to increase their commodity exposure over the next three years. 57% of respondents expect the level of commodity inflows in 2010 to be \$60 billion or greater.”<sup>6</sup>

The Commodity Exchange Act states that “such limits upon positions and trading shall apply to positions held by, and trading done by, two or more persons acting pursuant to an expressed or implied agreement or understanding, the same as if the positions were held by, or the trading were done by, a single person.”<sup>7</sup> Passive commodity indexes clearly meet these criteria and so should at least be severely limited, or in our opinion, banned from participating in commodity markets.

The results of these passive investments have a real effect on commodity prices. A recent study by Dr. Steffen Bukold of EnergyComment Hamburg, identified two types of price effects of speculator actions: short-term speculative waves (duration one or two months) borne by hedge funds and other money managers, and long-term speculative commitments (duration one or more years) borne by large institutional investors like pension funds, endowments, state funds and ETFs. He estimates that in early April 2010, the premium of a short-term speculative wave of \$8-12 per barrel and an additional premium of long-term speculative commitments of \$17-23 per barrel. This puts the total speculative premium at about \$30 per barrel, or 35 percent.<sup>8</sup> Sean Cota of Cota & Cota Oil estimated that people in the U.S. are paying one dollar more per gallon of gasoline because of excess speculation.<sup>9</sup>

### **Peak Oil**

Maryknoll OGC believes it is especially important to act quickly to stop excessive speculation in crude oil markets because we are nearing the global peak in oil production. According to the Royal Swedish Academy of Sciences, 54 of the 65 most important oil-producing countries have reached or surpassed peak production and the rate of

---

<sup>6</sup> Institutional Investors Ready for Record Commodity Investment in 2010, Dec 10, 2009  
<http://www.commodities-now.com/news/portfolio-management/1305-institutional-investors-ready-for-record-commodity-investment-in-2010.html>

<sup>7</sup> 7 USC 1.6a(a)

<sup>8</sup> Inflated Car Fuel Prices in Germany and Crude Oil Speculation, pg. 3, April 6, 2010  
[http://www.carboncapturereport.org/cgi-bin/biodb?PROJID=9&mode=viewpersonname&name=dr\\_steffen\\_bukold](http://www.carboncapturereport.org/cgi-bin/biodb?PROJID=9&mode=viewpersonname&name=dr_steffen_bukold)

<sup>9</sup> Quotes from press conference on commodity speculation, Feb. 4, 2010  
<http://stopgamblingonhunger.com/?p=498>

discoveries of new reserves is less than a third of the present rate of consumption.<sup>10</sup> In a Feb 2007 report sponsored by the U.S. Department of Energy, National Energy Technology Laboratory a survey of energy market experts who had made predictions of when the world would reach the point of peak oil, the majority fall between 2005 and 2020.<sup>11</sup> The report cites the Energy Information Agency, “(Our) results (related to oil peaking) are remarkably insensitive to the assumption of alternative resource base estimates. For example, adding 900 Bbbl (billion barrels) – more oil than had been produced at the time the estimates were made – to the mean USGS resource estimate in the two percent growth case only delays the estimated production peak by 10 years. Similarly, subtracting 850 Bbbl in the same scenario accelerates the estimated production peak by only 11 years.”

When peak oil production does occur, there will be huge profits to be made by betting on rising oil prices as they are guaranteed to rise. If we do not address the problem of excessive speculation now, then speculators will be able to take advantage of peak oil by driving prices even higher than they would have without their added investments. This would be disaster for the global economy.

### **Concerns with the Proposed Rules**

Our first concern with the Proposed Rules is that the limits suggested in the proposal are too high to be effective. As analysts from Commerzbank said soon after the CFTC announcement of possible limits, "Position limits are so generous that we do not expect any direct market impact."<sup>12</sup> CFTC staff estimated that only ten market participants would be affected by the limits.

Our second concern is that it places position limits only on individual speculators without considering the cumulative effect of speculators in the markets. By limiting individual investors, the proposal will stop manipulation in the markets, but will not address the cumulative weight of speculators in the market. As stated in your proposal on page 4145, “... unchecked speculative positions, even without intent to manipulate the market, can cause price disturbances.” We would prefer a limit on the total amount of speculation in the market by establishing a maximum percentage of open interest for speculators. It is beyond our expertise to say what that percentage should be, but imagine that it should be well under 50 percent.

---

<sup>10</sup> Statements on Oil, pg. 2, 14 Oct 2005 <http://www.kva.se/en/Science-in-Society/Energy-Committee/Oil/>

<sup>11</sup> Peaking of World Oil Production: Recent Forecasts, DOE/NETL-2007/1263, February 5, 2007, pgs. 10-12 [www.netl.doe.gov/energy-analyses/pubs/Peaking%20of%20World%20Oil%20Production%20-%20Recent%20Forecasts%20-%20NETL%20Re.pdf](http://www.netl.doe.gov/energy-analyses/pubs/Peaking%20of%20World%20Oil%20Production%20-%20Recent%20Forecasts%20-%20NETL%20Re.pdf)

<sup>12</sup> CFTC's sabre-rattling fails to tackle the over-the-counter commodities market, Jan 18 2010 <http://www.telegraph.co.uk/finance/markets/7012273/CFTCs-sabre-rattling-fails-to-tackle-the-over-the-counter-commodities-market.html>

Our final concern is that the proposal will not stop passive speculation, which we consider to be most destructive, as we explained above and in our response to question number 15 below.

### **A Final Appeal**

Maryknoll missionaries have a long history of working with some of the most marginalized communities in the world, so in every policy area, we look to see how proposed changes will affect those communities. Increases in the price of food commodities (also heavily influenced by oil and gas prices due to the heavy dependence of our global food system on fossil fuels) affect those with lower incomes most heavily because they spend a higher portion of their income on food. Very low income families in developing countries are especially heavily affected because they often buy raw commodities in bulk, such as sacks of wheat and corn. So when the price of wheat triples, as it did between January 2005 and April 2008, the price of their food increases the same amount. This is different than for middle class families who buy processed foods where the actual commodity price is a small portion of the overall food item price.

The Commission has a real opportunity to improve the lives of the poorest people in the world by guaranteeing that speculators are not able to drive prices up unnecessarily as they did in 2008. We are sure that there are many pressures on the Commission from end users, index fund and ETF managers, etc., but we imagine that you hear very little from those around the world who were most severely affected by the energy and food bubbles of 2008. We ask that when you make your decision, you consider how it will affect the poorest people in the world who are the most vulnerable to price swings. Your decision will not only affect those who invest in commodities, but the very ability of people around the world to feed their children or to even survive. It is certainly not an easy task, but we pray that you will make the right decision.

### **Responses to specific questions**

Below are our responses to the questions for which we have opinions:

*1. Are Federal speculative position limits for energy contracts traded on reporting markets necessary to “diminish, eliminate, or prevent” the burdens on interstate commerce that may result from position concentrations in such contracts?*

Yes, position limits are necessary to avoid both manipulation and excessive speculation, goals that the Commodity Exchange Act defines for the CFTC.

*2. Are there methods other than Federal speculative position limits that should be utilized to diminish, eliminate, or prevent such burdens?*

We believe that alternatives to position limits such as “accountability” limits and higher margin requirements will not be adequate to eliminate excessive speculation.

*3. How should the Commission evaluate the potential effect of Federal speculative position limits on the liquidity, market efficiency and price discovery capabilities of referenced energy contracts in determining whether to establish position limits for such contracts?*

Speculators are important to provide liquidity to the commodity markets so that producers and consumers of physical commodities can hedge – the principal reason for the existence of these markets. Too little liquidity hampers these legitimate users of commodity markets, but there can be too much liquidity from speculators, as exists today, which results in excessive speculation, throwing off the price discovery function.

Currently, legitimate hedgers complain of too much speculation. One technique the Commission could use would be to gradually reduce position limits until there is a notable lack of liquidity, when the Commission could raise the limits again. But it is clear that today, those position limits need to be lowered significantly.

A concern we have is that if position limits are the same for all participants without singling out the particularly destructive passive investments for stricter limits, this could result in removing more active speculators than passive speculators.

*10. The Commission's proposed part 151 regulations for referenced energy contracts would set forth a comprehensive regime of position limit, exemption and aggregation requirements that would operate separately from the current position limit, exemption and aggregation requirements for agricultural contracts set forth in part 150 of the Commission's regulations. While proposed part 151 borrows many features of part 150, there are notable distinctions between the two, including their methods of position limit calculation and treatment of positions held by swap dealers. The Commission seeks comment on what, if any, of the distinctive features of the position limit framework proposed herein, such as aggregate position limits and the swap dealer limited risk management exemption, should be applied to the agricultural commodities listed in part 150 of the Commission's regulations.*

We believe the regulations for agricultural commodities in part 150 do not need to be revised except to include passive investments like commodity indexes and ETFs. Part 151 covering energy commodities should also cover these passive investments.

*11. The Commission is considering establishing speculative position limits for contracts based on other physical commodities with finite supply such as precious metal and soft agricultural commodity contracts. The Commission invites comment on which aspects of the current speculative position limit framework for the agricultural commodity contracts and the framework proposed herein for the major energy commodity contracts (such as proposed position limits based on a percentage of open interest and the proposed exemptions from the speculative position limits) are most relevant to contracts based on other physical commodities with finite supply such as precious metal and soft agricultural commodity contracts.*

Maryknoll OGC is in favor of position limits for soft commodities for two key reasons. Many developing countries are heavily dependant on the export of soft commodities like coffee, cocoa, and sugar, so it is especially important to guarantee that the prices of those goods cannot be manipulated or otherwise influenced by speculators. We are also concerned that if position limits are only placed on energy and some agricultural commodities, index funds could shift their compositions into these soft commodities that have no limits.

As precious metals are not necessary for life and are most often used not for consumption, but as a store of value, we do not think it is necessary to place position limits on these commodities. However, for industrial metals that are the foundation of our economy, many of which are approaching peak production levels in coming decades, we ask the Commission to consider position limits on these commodities.

*15. Concerns have been raised about the impact of large, passive, and unleveraged long-only positions on the futures markets. Instead of using the futures markets for risk transference, traders that own such positions treat commodity futures contracts as distinct assets that can be held for an appreciable duration. This notice of rulemaking does not propose regulations that would categorize such positions for the purpose of applying different regulatory standards. Rather, the owners of such positions are treated as other investors that would be subject to the proposed speculative position limits.*

*a. Should the Commission propose regulations to limit the positions of passive long traders?*

We believe that the Commission should not only limit the positions of passive long traders, but ban them from entry into commodity markets. Investors have, literally, millions of investment options for their portfolios. There is no *need* for investors not directly involved in the production or consumption of physical commodities to use commodity markets. Passive investments consume liquidity and destroy the price discovery function of these markets. We cannot allow such essential markets to be unduly influenced by these indexes. The increase in world hunger that was partially caused by these indexes is completely unacceptable. Whatever losses investors will experience with a ban will not come close to comparing to the losses that people all over the world experienced in 2008.

Note that we are concerned not only with passively managed indexes but also emerging actively managed indexes<sup>13</sup>, and believe that these should also be banned from commodity markets.

*b. If so, what criteria should the Commission employ to identify and define such traders and positions?*

---

<sup>13</sup> [Rouwenhorst: The Case For 'Active' Commodity Investing](http://www.indexuniverse.com/sections/interviews/7209-geert-rouwenhorst-the-case-for-active-commodity-investing.html), Feb 3, 2010  
<http://www.indexuniverse.com/sections/interviews/7209-geert-rouwenhorst-the-case-for-active-commodity-investing.html>

Maryknoll OGC thinks that the Commission could use Section 2(h) (7) of the CEA to determine if the index funds meet the criteria for price discovery contracts. We believe that both passive and actively managed index funds do not meet these criteria.

*c. Assuming that passive long traders can properly be identified and defined, how and to what extent should the Commission limit their participation in the futures markets?*

These passive (and active) index funds should be banned completely from commodity markets. They provide no benefit to these markets while severely compromising their functioning and disturbing the larger economy.

*e. What unintended consequences are likely to result from the Commission's implementation of passive long position limits?*

We do not foresee any unintended consequences, but the intended consequences would be a notable decline in price volatility, an increase in liquidity and commodity prices that better reflect supply and demand fundamentals.

Thank you for your consideration,

David Kane

[dkane@maryknoll.org](mailto:dkane@maryknoll.org)

Associate for Latin America and Economic Justice

Maryknoll Office for Global Concerns

PO Box 29132

Washington, DC 20017

[www.maryknollogc.org](http://www.maryknollogc.org)

[www.stopgamblingonhunger.com](http://www.stopgamblingonhunger.com)