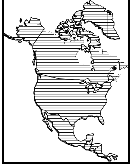

Industrial Energy Consumers of America
The Voice of the Industrial Energy Consumers

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May 15, 2020

Via Electronic Submission

Mr. Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
Washington, DC 20581

Re: Position Limits for Derivatives, RIN 3038-AD99

Dear Mr. Kirkpatrick:

The Industrial Energy Consumers of America (IECA) appreciates the opportunity to provide comments to the Commodity Futures Trading Commission (CFTC) on this very important proposed rule. The CFTC is to be commended for pursuing limits to speculative trading. All of our comments are related exclusively to natural gas. All of our companies are bona fide hedgers.

I. BACKGROUND

The Industrial Energy Consumers of America is a nonpartisan association of leading manufacturing companies with $1.0 trillion in annual sales, over 4,000 facilities nationwide, and with more than 1.7 million employees. It is an organization created to promote the interests of manufacturing companies through advocacy and collaboration for which the availability, use and cost of energy, power or feedstock play a significant role in their ability to compete in domestic and world markets. IECA membership represents a diverse set of industries including: chemicals, plastics, steel, iron ore, aluminum, paper, food processing, fertilizer, insulation, glass, industrial gases, pharmaceutical, building products, automotive, independent oil refining, and cement.

IECA member companies are some of the largest manufacturing consumers of natural gas in the country, if not in the world. This means that relatively small increases to the cost of natural gas can have significant impacts on global competitiveness. These companies are potentially impacted by the NOPR. Excessive speculation can increase

price volatility, separate prices from the underlying supply and demand of the commodity, and increase costs.

The commodity market is very unique as compared to other markets. Commodity markets exist for the purpose of providing a marketplace between consumers and producers of physical commodities to hedge their risks. The role of the speculator is to ensure liquidity. Historically, when markets have worked well (prior to enactment of the Commodity Futures Modernization Act), the ratio of hedgers to speculators was about 70 to 30. Unfortunately, now it is the reverse with less than 30 percent hedgers and more than 70 percent are speculators that increase the potential for price volatility.

Section 4a(3) as amended by the Dodd-Frank Act instructs that speculative position limits, to the maximum extent practicable, should achieve four goals:

- Diminish, eliminate or prevent excessive speculation;
- Deter market manipulation;
- Ensure liquidity for bona fide hedgers; and
- Ensure that price discovery is not interrupted.

We believe the following to be true.

- Speculation in natural gas has dramatically increased and is excessive; and, if not for an oversupplied physical market, prices would be much more volatile.
- While increased speculation has increased the need for hedging by physical purchasers, the increased costs to such hedgers have caused physical purchasers to hedge less;
- The creation and explosive growth of natural gas index funds is of increasing concern;
- Natural gas index funds are liquidity takers and not liquidity providers;
- Natural gas index funds have the potential to disrupt the futures and physical markets in ways that can distort price discovery when the natural gas market is not oversupplied as it is today.

II. COMMENTS ON PROPOSED RULE

a. CFTC should not cede authority to commodity exchanges to determine bona fide hedge exemptions.

Congress gave the CFTC the authority and regulation of commodity markets. One of the most important determinations is to determine what entities are speculative traders and bona fide hedgers. The NOPR gives this responsibility to exchanges, albeit, with a ten-day window for CFTC to object. IECA opposes this change. It is very important for

CFTC to review applications for a bona fide hedge exemptions and make the decision. Not the exchanges.

Unlike the CFTC, commodity exchanges are not regulatory agencies established under law to protect the public interest. They are publicly-traded firms that benefit from higher trading volumes and larger number of market participants. In writing Dodd-Frank, Congress recognized that exchanges have a profit motive to institute broad hedge exemptions that may include non-commercial market participants (such as financial speculators). Giving exchanges this authority clearly runs contrary to the intent of Congress, which is that the CFTC – not the exchanges or self-regulatory organizations – should be tasked with determining who should be eligible for bona fide hedge exemptions.

b. **Natural gas index funds should be banned (or) limit their growth to the growth of the physical market – should not be classified a bona fide hedge.**

If we could, IECA would support completely banning natural gas commodity index funds from participating in the futures market. Since a ban is not likely, the Commission should limit the volume of natural gas index fund volume to roughly not exceed their current percent of the physical market. Finally, we urge the Commission to conduct a study on commodity index funds and weigh the cost versus benefits to commodity liquidity and risk.

Speculation in consumable commodities has grown dramatically in the last decade resulting in a significant rise in *passive speculation* by those seeking to "invest" in commodity derivatives through index funds. These are individuals or entities who, for example are seeking to invest in commodities just as they would in stocks or bonds. **The commodity futures market was never designed for this type of passive investor.** Today, passive speculators outnumber active speculators and account for a significant share of speculative open interest in many consumable commodities and especially natural gas.

Active speculators and passive speculators are very different. Active speculators add beneficial liquidity to the market by buying and selling futures contracts with the goal of a relatively quick profit. Passive speculators do the opposite; they drain liquidity by buying and holding large quantities of futures contracts. They act like a consumer who never takes actual delivery of the goods.

Passive speculators invest in a commodity or a basket of commodities (an index fund) and continually roll their positions forward as part of a diversification strategy. *The diversification strategy is completely blind to what is happening on supply or demand of the market.* This is a huge contrast to the active speculator who seeks to financially benefit from changes to the market and is ready to buy or sell based on market activity.

Passive speculators not only undermine, they destroy the price discovery function of the market and increase the potential for price bubbles like we saw for natural gas in August 2008.

The harm caused by commodity index funds has been well documented. The June 2009 report of the Senate Permanent Subcommittee for Investigation (PSI) on the role of excessive speculation in the wheat market is just one example. This bipartisan report concluded that the "activities of commodity index traders, in the aggregate, constituted 'excessive speculation,'" and that index funds have caused "unwarranted price changes" and constitute an "unwarranted burden on commerce." The PSI report urged the CFTC to take appropriate measures to limit the impact of index fund investments in commodities.

Thank you for the opportunity to make comments on this important rule.

Sincerely,

Paul N. Cicio
President

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