

Jan. 17, 2010 – The Power of the People

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The public meeting of the CFTC on the matter of position limits in the energy markets is now history. And was it ever historic. I will offer some observations on the meeting, followed by analysis and attempt to answer some of your early questions. This article is longer than I would have preferred and still doesn't address all the issues I wanted to cover. Please get back to me with any questions you may have, as they will probably be of interest to everyone. If you have not viewed the webcast or read the various statements, they are easy to retrieve at <http://www.cftc.gov/newsroom/cftcevents/2010/oeaevent011410.html> Please do so.

My first personal observation is Holy Cow! Chairman Gary Gensler and the other commissioners, especially Bart Chilton, exceeded all my expectations concerning silver and performed a great public service. They have brought great honor on themselves and to their office. I suppose some might say that's their job and that they might have done and said more and did so earlier. I say that when someone does what you ask of them, even if it is their job, you should say thank you. The first order of business is that everyone who has an interest in this matter, whether you wrote to them originally or not, should take the time to drop them a line saying thanks for a job well done. The journey is far from complete, but it is important to maintain the highest levels of professionalism and courtesy, especially when dealing with those at the highest levels.

Another observation is that the attention placed on position limits for silver and gold at this energy hearing occurred only because you took the time to write to the Commission beforehand in a professional manner. That should that make you feel a deserved sense of accomplishment, as it does for me. Make no mistake – there would have likely been no mention of silver or a proposed meeting on position limits in precious metals had you not written in. What I hope you learn from this is the power of collective action when undertaken with courtesy and constructive clarity. There is much you still must do, but you should be feeling empowered for what you have already accomplished.

One thing Thursday's historic meeting confirms is the validity of the issue of position limits and concentration in silver. This is at the heart of the silver manipulation, as I have maintained for too many years. There is no way, no matter how many of you wrote in, would the Commission have publicly even considered the issue if it had no merit. While there is no guarantee that the Commission will follow through and eventually do the right thing with the concentration on short side of silver, you should feel convinced that the issues of position limits and concentration in silver are valid. It is important to know that you are on the right side of a substantive issue.

Maybe I shouldn't say this, but I feel like we all showed up uninvited to a great party and because we behaved ourselves and added to the life of the party and grew so large in numbers that all that was left was to send out for more pizza and beer. This hearing was never about position limits in silver and gold, just energies. We invited ourselves and favorably added to the experience. Now we'll likely soon have our own party.

But it wasn't just the validity of the issue, the professional manner in which we conducted ourselves, or the sheer number of emails sent that made the difference. That's been done before, under different chairmen, to no great effect. The main difference this time is Gary Gensler. Without him as chairman this whole effort would have been dead on arrival. Not only do I not have to retract any of my past glowing praise for him, I regret wavering recently that the silver situation may be too far gone for him to deal with. That may still turn out to be the case, but for today I think we should savor the moment and be thankful Gensler is at the helm.

One last initial observation. While the meeting on Thursday was widely reported in the main stream media, I was shocked at the collective low-level of comprehension displayed in the reporting afterward. For both the meaning and significance of the proposed position limits in energy derivatives and the announcement of the consideration for position limits in precious metals, I was amazed how so little understanding was displayed by the commentators. One thing it did confirm to me was how few of them, compared to you, grasped the real story in silver. That's great because it insures any big buying competition from them will only come in at much higher prices.

Now to the analysis of the meeting. The meeting lasted a little over 2 hours and 33 minutes. Right from the start, at the 02:35 minute mark, Chairman Gensler made the first reference to position limits in silver and gold, when he stated;

“Separately, the Commission is interested in hearing from the public as to issues related to the trading of futures and options in the precious metals markets, such as silver and gold, and to consider the appropriateness of position limits in those markets. I hope to have a public meeting on this separate topic in the beginning of March.”

Here are some selected comments from the Chairman's closing statement;

“Our duty is to protect both market participants and the American public from fraud, manipulation and other abuses. Central to these responsibilities is our duty to protect the public from the undue burdens of excessive speculation that may arise, including those from concentration in the marketplace.”

“A transparent and consistent playing field for all physical commodity futures should be the foundation of our regulations. Thus, position limits should be applied consistently to all markets and trading platforms and exemptions to them also should be consistent and well-defined.”

“When the CFTC set position limits in the past, the agency sought to ensure that the markets were made up of a broad group of market participants with a diversity of views. At the core of our obligations is promoting market integrity, which the agency has historically interpreted to include ensuring markets do not become too concentrated.”

As I recall, four of the five commissioners voiced their opinion that the issue of position limits in precious metals should be considered, with extensive reference to the issue by Commissioner Chilton. At around the 49:30 mark, Commissioner Chilton embarked on a very detailed discussion on position limits in metals with Steve Sherrod, Acting Director of Market Surveillance. (Sherrod was terrific, by the way). In this exchange, Commissioner Chilton pressed the case for position limits on precious metals. Chilton also took a pot shot at me (not by name) with his remark that no single entity held 40% of COMEX silver. More on that in a moment.

Along with his testimony and questioning throughout the meeting, it was in Commissioner Chilton's official closing statement that he fulfilled his promise to so many of you that he advocates position limits in metal. This a long excerpt, but I feel it is appropriate;

“Finally, the proposal seeks comment from the public on the question of expanding position limits to the metals complex and to soft agricultural commodities. While I am pleased that this question is at least posited through the proposed rule, I am extremely disappointed that metals are not a part of this proposal as I have sought. In essence, failure to include a proposed rule relative to metals such as gold and silver prevents the inclusion of metals in the final rule covering position limits in energy. As a result of the omission, CFTC attorneys have opined that should the Commission wish to establish position limits in metals as a result of public comment, the agency would have to undertake an entirely separate rulemaking. I strongly support thoughtful position limits in the metals complex. I have advocated for their inclusion in this proposal with each of my colleagues and staff, and regret the lack of consensus that remains. It is my sincere hope and expectation that the upcoming hearing on position limits with regard to metals will enable us to move more expeditiously on a parallel regulatory process for metals.”

As you might expect, I'm looking at this historic meeting through the prism of the silver market and my decades-old quest to witness legitimate position limits in COMEX silver. However, this meeting was not solely about silver; instead it mainly concerned energy position limits. Here, I think the Chairman and the Commission also did a great job. They addressed the two key components of a legitimate position limit program, namely, the actual level of position limits and who gets exempted from those limits. While not at all antagonistic to the exchanges, the Commission intends to take over the exchanges' previous responsibilities in this matter. And they did it with skill and finesse. For example, the Commission basically adopted the CME Group's formula for determining the level of position limits in each energy market, with some slight revisions. It would be hard for the Exchange to argue with its own proposal.

While I think that the proposed limits are quite high for energy contracts, I understand the Commission's goal to get hard limits in place despite the CME Group's objections. Energy is the life blood of the US and world economies. Big changes in energy prices have a profound impact on us all. The incredible volatility in oil and natural gas over the past few years brought great damage to the overall economy. I am still convinced that much of the volatility was caused by outsized positions turned sour (Amaranth's spread position in natural gas and SemGroup's short in oil, as well as the short merchants in cotton), and that should prompt the regulators to pay special heed to overly large short positions in the commercial category. There is a recurring theme of excessively large commercial short positions running into trouble. The good news is that were the Commission's proposed hard position limits, as well as the proposed limited exemptions, in effect back then, much of the devastating volatility would have been avoided. That's reason enough for the Commission to push ahead.

I'd like to make one vital distinction here between proposed hard position limits in energy and silver. While I applaud the Commission for its energy initiative and encourage them to complete the task when the weather is calm and clear, it is important to recognize that there is no immediate crisis in energy requiring position limits. That's because there is no noticeable concentration present. If one studies the COT concentration data in energies, you are struck with how un-concentrated is the energy market, particularly crude oil. The proposed changes in energy position limits should have no immediate impact on prices, even if they were much lower. In COMEX silver, there is a clear need for an immediate crack down on the big short, JPMorgan. It's good that the Commission is moving on energy position limits. It's deplorable that they have not yet moved to halt the crime in progress that surely is present in COMEX silver.

The formula used to determine the maximum position that any one speculator can hold in the big energy contracts on an all-months-combined basis is based upon the level of total open interest in each market. It works like this; an energy speculator would be allowed to hold up to 10% of the first 25,000 contracts of open interest, and then no more than 2.5% of the total open interest above 25,000 contracts. I'm not quite sure of the logic behind the 10% calculation, and 2.5% is certainly higher than I would prefer, but it is important to codify position limits. If, as Commissioner Chilton has said, this formula proves too high, it can be adjusted later. For political purposes, the proposed crude oil limit, according to the formula and the total open interest of 1,300,867 contracts in the latest COT report, would be 34,397 contracts on the NYMEX. This is an increase of 14,397 contracts, or 72%, over the current 20,000 contract accountability limit. Of course, current accountability limits are exceeded consistently, while it is presumed hard position limits won't be exceeded at all.

The Commission and staff were quick to point out that this formula was intended for energy futures and options contracts and that each commodity market must be considered separately. For instance, applying the proposed energy formula to CBOT wheat, where a hard position limit of 6500 contracts already exists, would result in a new position limit of 11,427 contracts (based upon latest COT data). I hardly think that the Commission would endorse an increase of 75% in the wheat position limit, especially when the 2009 Senate Wheat Report was suggesting lowering the position limit instead. My point is that the Commission's formula was clearly intended solely for the energy markets.

It is instructive, however, to play "what if" and apply the energy position limit formula to COMEX silver and gold. I'll use the total open interest figures in the most recent COT report of Jan 15, of 128,675 contracts in silver and 523,266 in gold. Using the energy formula for silver (10% of the first 25,000 and 2.5% of the balance) would result in a position limit of 5092 contracts. This is a reduction of more than 900 contracts from the current 6000 contract accountability limit in effect, but a far cry from the 1500 contract position limit that I espouse. Please bear with me.

The same energy formula applied to COMEX gold futures would result in a position limit of 14,957 contracts, compared to the current accountability limit in COMEX gold of 6000. In other words, gold's position limit would go up by two and a half times using the energy formula, while silver's would decline by 15%. I doubt very much that the Commission intends to eventually propose a hard position limit in COMEX gold futures of 15,000 contracts. My point is different. As I have consistently maintained, it is the current 6000 contract accountability limit in silver that is the only aberration. (I should note that there is a provision in the formula that further reduces the hard position limit to no more than 67% of the all-months-combined level in any single month. This is a well-thought out addition and would reduce the limit in silver to 3412 contracts in any one month if the energy formula was rigidly applied to silver).

Since COMEX gold open interest is four times larger than COMEX silver open interest, gold should have a position limit four times larger than silver. Alternatively, and more sensibly, silver's position limit should be one-fourth the position limit in gold. Make gold's current 6000 accountability limit into a hard position limit of that same amount, just make silver's hard limit 1500 contracts. I believe that applying the energy formula to every commodity would result in a substantial increase over current hard position or accountability limits except for one, silver. The only commodity where the actual position limit needs to be reduced is silver, not gold or any other commodity. This issue is incredibly specific to silver.

The issue of the actual level of hard position limits is only 50% of the equation. Perhaps even more important is deciding which entities would be exempt from those hard limits due to bona fide hedging needs. Here, I believe the Commission is proposing great improvements. First, it is proposing taking back that function from the exchanges, and rightly so. Further, it is standardizing the process to make it more formal and objective. Hopefully, no more wink and nod when an entity masquerading as a commercial hedger wants to speculate aggressively is given a pass to do so by the old boy network at the exchange. The Commission also intends to make public, after a six month delay, those entities granted exemptions from position limits. This is all good stuff and a big improvement.

But if the issue of hedging exemptions to position limits is 50% of the equation overall, this issue is 99% of the equation in silver. Let's be frank here. While the limit in silver should be 1500 contracts, there is no real position limit problem in silver whether the limit is 6000 or 1500 or somewhere in between. The real problem is the concentrated short position held by JPMorgan and others. The biggest four long traders in COMEX silver (as of the latest COT report) hold an average position of 3539 contracts each. The four largest shorts hold an average position of 15,345 contracts each, or more than 4.3 times more than the big longs. This is a mismatch of unprecedented proportions for any major market.

It should scream out to you (as well as the Commission) that there is something seriously wrong here. The four largest shorts in COMEX silver hold 61,378 contracts, or more than 67% of the entire market, when non-commercial and commercial spreads are removed. In real world terms, these four traders are short 306,890,000 ounces, or more than 46% of the entire world annual mine production. No other commodity comes close to that. That is a level of size and concentration that is completely at odds with the meaning of the historical meeting. And all these short traders appear to be purely financial entities, primarily US banks. There is not a bona fide miner or producer among them. There is not just a position limit problem in silver, even though the limits should be sharply reduced. There is a clear problem with a couple of large banks shorting unimaginable quantities which has the clear impact of manipulating the silver price. Let's be honest - take JPMorgan out of the silver market and there is no manipulation.

Let me address the assertions that Commissioner Chilton made during the hearings about the big short position being 23% and not the 40% that I have stated. I want to be very respectful and constructive here, and not have this evolve into petty semantics argument. I believe my numbers are correct. I think Commissioner Chilton is using numbers (given to him) that do not remove spread transactions and may include options transactions, both of which would greatly understate the true level of real concentration. He is quoting data not available to the public. I was all prepared to list the articles in which I had already gone over this with Commissioner Chilton and vigorously debate it again, but I have decided that might be unproductive. It's time to stop arguing and get this thing fixed. I propose a constructive solution, as my intent is to end a clear silver manipulation in progress, or to become convinced that the market is operating freely. I'm sure Commissioner Chilton would agree with that. How about the Commission stop with their avoidance at all costs approach to silver and initiate a constructive and open dialogue? It has to come sooner or later.

The fact is that the Commission has run three expensive and time-consuming silver investigations in the past several years, one of which is open. In none of these investigations has the Commission seen fit to contact me, even though I was the instigator behind all three investigations. I'm not trying to shine the spotlight on myself, but that process is kind of silly and wasteful of taxpayer funds. The current investigation started as a result of my allegations of concentration following the release of the August 2008 Bank Participation Report which showed an extraordinary concentrated short position in COMEX silver (and gold). Instead of answering the simple question, "how can one or two US banks being short 25% of world production not be manipulative?" the Commission launched an investigation (at Commissioner Chilton's request). That question has remained unanswered.

The impetus behind the proposed hearing on position limits for metals and the current silver investigation is the same. It all involves the massive and unprecedented silver short position by JPMorgan and others. Let's cut to the chase here. What's the economic justification for this concentrated short position? No bank produces metal. Since they are not producers of the actual metal, but pushers of fraudulent paper, they don't fit the Commission's own profile for who should be granted a bona fide hedging exemption from position limits.

Commissioner Chilton also took the time to point out that those (me) fingering JPMorgan as the big silver short were only surmising that. But neither did he deny that JPMorgan was the silver short. Look, I know that the CFTC is barred, by statute, from revealing the identity of any trader. But I also know that JPMorgan's short position is so egregiously large and concentrated that it is relatively simple to see that they are the big silver short from public CFTC and Treasury Dept data. At least Commissioner Chilton was straightforward in stating the percent concentration he quoted, 23%, was still too high. I agree. But he is the Commissioner, not me, and should do more to lower what he states is too high.

This raises another issue. The public data clearly indicates that it is primarily a couple of US banks holding the big silver short position. Have we lost our collective minds? The big banks (along with AIG) are responsible for every financial problem that exists today. These big banks have no right to speculate on the scale of their concentrated short position in silver. The country needs them to take deposits and make loans, not manipulate the price of silver. The CFTC stands in the unique position of helping the country and setting an example for other regulators by standing up to JPMorgan and their short position in silver.

The message I wish to impart today is that there is much work to be done, as the silver manipulation remains a crime in progress. I think we can end that crime together. But there is much to celebrate as well. Your collective actions made a big difference in influencing the meeting. That is undeniable. Just like we step back and rejoice in a marriage, or a birth, or a child graduating, you should celebrate the achievements recorded in Thursday's historic meeting. The Commission did what you asked them to do. It is a time to thank them, as that is the proper thing to do. Soon we'll press the specific case in silver anew.

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Date Created
2010/01/17