UNITED STATES OF AMERICA

COMMODITY FUTURES TRADING COMMISSION

PUBLIC MEETING TO EXAMINE FUTURES AND OPTIONS TRADING IN THE METALS MARKETS

Washington, D.C.

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P R O C E E D I N G S

CHAIRMAN GENSLER: Good morning. I'd like to call to order this public meeting of the Commodity Futures Trading Commission to examine the trading of futures and options in the precious and base metals markets and to consider federal position limits and related exemptions within these markets.

I want to first start by thanking my fellow Commissioners, it's good to be all together, and the distinguished panelists that we'll be having here today. We look forward to hearing from a diverse group of participants about many aspects of the metals market.

Today's meeting builds upon the ongoing look that we as a Commission have had in regulating futures and options and commodities -- on commodities of finite supply. Some, as you recall, last July and August, the Commission had three open meetings to discuss the energy markets, and it was very informative and insightful. In January, the Commission had a public meeting, as well, and voted out a proposed rule to possibly reestablish position limits in the energy markets and also a rule concurrent with that granting -- bringing uniformity to granting exemptions in those markets. We continue to receive comment letters on that, and the public is encouraged and interested members certainly to continue to submit letters through April 26, next month. You can find the instructions at their web site, www.CFTC.gov.

But in today's meeting, we turn to the metals markets. And the issues of position limits will be the central issue today, but actually the intent is a little broader than that, it's to hear and discuss the many issues related to the metals futures markets.

In particular, at least I'm interested in hearing panelists' views on how the price discovery markets in metals work and how it relates to the cash markets, as well, interested in how the U.S. futures markets relate to the international markets in metals and the over-the-counter metals derivatives marketplace, as well.

And the panelists' views on differences between metals markets and energies markets, we sort of went in depth there, but to hear some of those differences; what significance is the fact that the metal markets are more concentrated than the energy markets mean. I'm also interested in the role of hedgers and speculators and exchange traded funds and index funds in the marketplace. So I look forward to hearing all of the panelists' views on this, and certainly their views on one of the central issues today, on whether we should reestablish position limits in the metals markets, and if so, what those limits would look like and whether, most importantly, whether they'd really promote the integrity and efficiency of the markets, which I think is a core mission of the CFTC.

If they were reestablished, what formulas might be used? Might they be similar to what we proposed just a month or two ago in the energy markets or have been used in agriculture or something else? What type of exemptions might be appropriate, if at all?

So I look forward to hearing from everybody and getting and benefiting from the diversity of views. I think I'm supposed to say also that on this hearing, we're also weaving and encouraging the public to submit comments by April 30, 2010. I think that there is a way to do that, which is, metalshearing@CFTC.gov. And if I can read it, it's m-e-t-a-l-s-h-e-a-r-i-ng@CTFC.gov.

But with that, I was going to turn to see if any of my fellow Commissioners have just a little opening statement; Commissioner Dunn.

COMMISSIONER DUNN: Thank you, Mr. Chairman. And I commend you for having these meetings. At the last one that we had on position limits and energy, we had a Latin lesson. It would seem today we're going to get a lesson in Greek, so I'm looking forward to hearing from the panelists.

And it occurs to me that there was a great deal of effort that went in from all the panelists that provided stuff for us, that gave us a good deal of background reading, I appreciate that.

The mission of the CFTC is two-fold, it's to protect market users and the public from fraud, manipulation and abusive practices relating to the sale of commodities and financial futures and options, and two, to foster open, competitive and financially sound futures and options markets.

I hope today that our panelists will be able to shed some light on how the metals markets are currently working and whether the CFTC is fulfilling its mission to keep the markets open, competitive and free from unlawful conduct.

Over the last couple of years, some market users have raised concern that certain metal markets may not be free of abusive trading practices. When I first heard of these concerns, I asked our Division of Enforcement to examine the allegations of wrongdoing, and an investigation was opened and is still underway. Now, usually we don't tell folks when we're doing an investigation, but former Chairman Lugin did make that announcement that we were looking at a particular metal -- an investigation.

Well, we have not yet completed this investigation. I think it's important to remember that trading in the futures and options market is a zero sum game. For every winner, there is necessarily a loser. Several of today's panelists and market users have written the Commission and supported the implementation of position limits in metals markets.

With potential position limits in the energy markets, I am concerned that position limits in regulated futures markets, without corresponding limits, and the over-the-counter markets may result in less transparency in our markets if those presently trading on exchanges move to over-the-counter and other opaque markets to circumvent CFTC regulations.

I'm very interested in hearing from our panelists, their thoughts on this particular concern. I look forward to hearing from this diverse group gathered here today to speak. I look forward to a lively, robust and educational discussion. I appreciate the efforts the Commission staff has put into this meeting, and I would like to thank the panelists for appearing today. Your time and efforts will be instrumental in helping the Commission to better understand how the metal markets are operating.

My commitment to you is to listen with an open mind to your thoughts on the subjects. I think you in advance for your participation.

CHAIRMAN GENSLER: Thank you, Commissioner Dunn. Commissioner Sommers.

COMMISSIONER SOMMERS: Thank you, Mr. Chairman, and I want to thank all of you for being here today at this public meeting to examine the trading of futures and options in the precious and base metals markets. I'd like to thank in particular Commissioner Chilton for his leadership in this area.

This has been an area of public interest since and I came to the Commission in 2007, and I think that this is an appropriate time for us to look at these markets as we're considering position limits and other commodities like energy, that we also examine the metals markets. I also want to thank the Chairman for holding another public meeting. We've had a number of these public meetings during his chairmanship and I just want to reiterate how beneficial I think that these meetings are, not only to us at the Commission, but to the public, the general public that is interested in these futures markets to understand the complexity of the issues that are surrounding, issues like position limits. These are important issues, and we have a lot of things to consider when we are considering these limits.

I'm also grateful to all the panelists. I think we have a very diverse group of people testifying today and I'm very interested in hearing more about these important issues. Thank you.

CHAIRMAN GENSLER: Thank you, Commissioner Sommers. Commissioner Chilton.

COMMISSIONER CHILTON: Look, you all know my history on this issue, I support position limits in the metals complex to prevent and deter manipulation and stop excessive speculation. I think it's a professional grade regulatory tool that we need to protect consumers. And I hope this hearing helps put us on a fast track to getting the proposal out there. Thanks.

CHAIRMAN GENSLER: Thank you, Commissioner Chilton. And I do thank you, as Commissioner Sommers said, for your leadership on this issue. Commissioner O'Malia.

COMMISSIONER O'MALIA: Thank you, Mr. Chairman, and I'd like to thank all the panelists for their participation, especially the CFTC staff. I've now been a Commissioner at the CFTC for the past six months, it has been a very busy time. In particular since I started in October, I've received countless emails from participants in the metals markets.

Today's meeting acknowledges that the Commission is heard, the concerns of the market participants, therefore, I am pleased that we have a public meeting to receive information from this diverse group involved in these markets.

Based on my initial review, it is clear to me that the metals markets are uniquely global in nature. One must acknowledge this as the starting point for any well rounded discussion on the subject.

The United States, and more pointedly, the exchanges registered with the Commission, are not the markets epicenter. Significant price discovery in these markets takes place abroad in London; after all, it is the only location for the London fix for gold and silver. As for NYMEX -- just as NYMEX's WTI contract provides the benchmark for global oil prices.

In short, these markets are complex and involve diverse players with diverse objectives ranging from hedging manufacturing operations, maintaining central bank reserves, speculation on prices, and, of course, passionate retail investors. Therefore, any analysis of these markets and any actions by the Commission must take into account the global nature of these markets.

We must ensure that any rules and regulations do not offer any opportunities for regulatory arbitrage or deep creased transparency of U.S. markets or any other markets forcing activity to less transparent trading.

I'd like to thank the staff and the Commission and the members of the panel for their hard work to represent the Commission with their testimony and responding to our questions. I also appreciate the hard work of the Division of Enforcement, the Division of Market Oversight in the Office of the Chief Economist to support our investigation of metals markets. I look forward to a well rounded discussion today. Thank you.

CHAIRMAN GENSLER: Thank you, Commissioner O'Malia and all my fellow Commissioners. I'd like to -- our first panel, our General Council, Dan Berkovitz, our Acting Director, I like to say Director, our Division of

Market Oversight and Surveillance, Steve Sherrod, who both have done an excellent job in preparation for this hearing, but have testified so many times before, it seems that you're repeats here, and you'll be at the next hearings, too, guys. But I didn't recall which order we're going to do this in. Oh, all right.

So General Council Berkovitz, please. And if you can try to keep it, you know, a little bit brief, but you're full -- to the public listening and to people in the audience, their full presentations are going to be on our web or may actually -- are they up? They're apparently already up on our web site, so that's good, so Dan.

MR. BERKOVITZ: Thank you, Mr. Chairman and Commissioners. I will provide a short history of position limits in the futures markets for metals commodities. Since 1936, the Commodity Exchange Act has directed the CFTC to establish such limits on trading as it finds "are necessary to diminish, eliminate or prevent such undue burdens on interstate commerce that result from excessive speculation and futures markets for those commodities." After the passage of the 1936 Act, the Commission set position limits for wheat and other grains. Later, the Commission established position limits for cotton and several other agricultural commodities.

Over the next several decades, for some of the commodity futures that were not traded on federally regulated exchanges such as the livestock commodities, the exchanges set their own position limits.

In 1974, the CFTC was created and its jurisdiction expanded beyond the agricultural commodities listed in the CEA, to include futures contracts for any commodity. At the time, there were no position limits for any of the futures contracts for metals.

In adopting the 1974 amendments, the Congress highlighted the need to regulate the futures market for silver. The Senate Agricultural Committee urged the Commission to conduct hearing on "the proper speculative limit for silver futures trading."

The Conference Committee urged the Commission to "regulate effectively futures trading in all commodities, including silver, immediately on the effective date of this Act." In the following years, the Commission studied and deliberated as to whether and how to establish position limits for the new commodities in its purview. In 1977, the Commission considered, but decided not to adopt position limits for the silver markets.

The crisis in the silver market in 1979 and 1980 precipitated by the Hunt Brothers because the catalyst for the Commission's proposed rule in late 1980 to establish position limits for all commodity futures.

At one point during the crisis, two groups of traders, the Hunt Brothers and Conte Group held long positions in the March 1980 silver futures contract amounting to 122 percent of the total silver stocks and license depositories.

In 1981, the CFTC adopted a final rule to require the exchanges to establish position limits for commodities that were not already subject to Commission set limits. Prior to 1993, the Commission used several criteria to establish the levels of a single month and all months combined limits. These included the breadth and liquidity of the cash market, the financial exposure of traders in the event of limit price moves, and the extent to which limits would constrain trading. In 1993, the Commission adopted an open interest formula for determining position limits. The formula provided that the combined futures and options speculative position limits for both a single month and for all months combined be set at ten percent of open interest up to an open interest of 25,000 contracts, with a marginal increase of 2.5 percent thereafter. The Commission also permitted exchanges to establish position limits based on this formula.

In 1992, the Commission granted an exemption from the position limit requirement to permit the CME to use position accountability for several of its financial contracts. Position accountability levels were not fixed limits, but rather levels that would trigger further review of a trader's position.

Six months later, the CFTC determined it would also grant requests to permit position accountability to be used for highly liquid energy and metals contracts. In 1999, the Commission issued a rule that formally recognized the practice of position accountability in months other than the spot month.

Also in 1999, the Commission formally adopted a rule requiring that the spot month speculative position limit be no greater than 25 percent of the spot month deliverable supply. Previously, since 1981, the Commission had applied this rule as a matter of administrative practice in reviewing applications for a designated contract market. The Commodity Futures Modernization Act of 2000 statutorily authorized the use of position accountability.

The CFMA did not alter, however, the Commission's mandate or authority in Section 4A to establish position limits as it finds it necessary. I'll now turn to a description of the metals commodity position limits.

The first position limits for silver futures contracts were imposed by the Chicago Board of Trade in 1979, in October, 1979, as an emergency measure during the Hunt Silver Crisis. And you can see the silver is the black line on that chart that goes all the way back to 1980. You can see that's the first one and that was imposed in late 1979, during the Hunt Crisis.

The COMEX imposed emergency limits in January, 1980, during the crisis. In April, 1980, the Commission approved permanent speculative limits for the silver futures contracts at the CBOT and COMEX at the same levels that had been opposed by the exchanges during the crisis. These limits at the COMEX were set at 500 contracts for the spot next month and 2,000 contracts for the all futures months combined. The CBOT's limit was set at 600 contracts in any one future or all futures combined. In August, 1984, the CFTC approved amendments permitting the COMEX and CBOT to increase speculative position limits for the silver futures contract to 1,500 contracts in the spot month and 6,000 contracts in a single month and all months combined. And you can see the black line on that chart jump up in 1984, when that increase was approved.

In 1992, the CFTC approved amendments to COMEX rules replacing speculative position limits with position accountability standards in the non-spot months for the silver futures contracts.

The accountability levels were originally set at 7,500 contracts, but have since been reduced to 6,000 contracts. The spot month speculative position limits remained the same, at 1,500 contracts. And you can see in the metals markets, the metals markets moved to accountability levels in the 1980's, where the energy markets did not move to the accountability levels until the 2000's, after the CFMA, but these were imposed in the 1990's. I mean 1990's for the accountability levels. The silver and gold futures contracts that were formerly traded on the CBOT are now traded on NYSE Liffe. The NYSE Liffe silver and gold futures contracts have fixed position limits rather than accountability levels for individual months and all months combined. But the fixed position limits are numerically equivalent to the COMEX silver and gold futures contracts accountability levels.

The 1983 speculative position limits were established for the COMEX gold futures contracts at 3,000 contracts for the spot month and 6,000 contracts for single month and all months combined. You can see gold here is on the -- the gold -- the red line, the gold is on the red line on these charts.

As with silver, the COMEX, in 1992, replaced speculative position limits with the position accountability standards for non-spot months in the gold futures contracts. These were 7,500 contracts. Again, like silver, the accountability levels for gold were later reduced to 6,000 contracts in 1994.

The other commodities are on the chart, copper, platinum, we can detail those if necessary. Also, we have a chart on the exemptions and the spot month limits showing exactly where those were. A number of exemptions from the spot month position limits have been issued in the gold, silver and copper markets. Five traders have been issued exemptions as of February 26, 2010, for gold, five for silver, and less than four for copper; I don't have the exact number for that. And that concludes my statement. I'd be happy to answer any particular questions.

CHAIRMAN GENSLER: Why don't we hold our questions until Steve Sherrod gives his presentation, but I thank you, General Council Berkovitz.

MR. SHERROD: Thank you. This morning I'll present two sets of information regarding gold, silver and copper. The first set is a summary of trading volume in select markets during

2009. And the second set of information provides a view of large traders and concentrations in those markets during a sample period of 2008, 2009, and through this year to about a week ago.

The information comes from our aggregate statistics, from our large trader reporting system, and by way of reminder, Section 8 of the Commodity Exchange Act does not generally permit the Commission to publish data and information that was separately disclosed to business transactions or market positions of any person.

As the Chairman mentioned, gold, silver and copper are traded around the world on many different exchanges. Gold price discovery occurs around the world. And in 2009, for the cash forward and futures markets, in six different major markets, the London Bullion Market Association accounted for about half of the trading volume. The LBMA is a market portrayed spot cash and short dated forward contracts. It is a commercial market in that they trade participant to participant, but they do conduct a central price discovery process every day that's called the Daily Fix, it occurs twice.

There are five participants. They hold a conference call, and during this conference call, they reach out to their customer base, the chair starts the price discovery process. Each of the five participants on behalf of their customers enters orders to sell and buy. If there's a general match, the price is fixed; if there's an imbalance, they continue moving the price until there's a relative balance between the buys and sells. So that's about half of the volume in 2009 moving through both the spot for markets in LBMA. COMEX accounts for about one- third.

Turning to silver, in 2009, five venues, five of the leading venues that traded silver, COMEX accounted for about half of the trading volume, and the LBMA accounted for about one-third. These volumes, by the way, are equalized in terms of ounces and not in terms of number of contracts. Turning to copper, in 2009, the London Metal Exchange accounts were over half of the trading volume. The Shanghai Futures Exchange accounts for over a third. And COMEX accounts for only a sliver of the world volume when we measure this in terms of tons.

The second part of the data that I have for you today is aggregate data, as I mentioned. These are for the U.S. reporting markets that we collect data through our large trader reporting system.

To provide transparency to the public, the Commission publishes in the form of a Commitment of Trader's Report, aggregate statistics based on Tuesday's open interest for markets in which there are 20 or more traders.

The graph that we see here is gold on a net futures and options combined basis by traders. The trader classifications are, the green line is the producer, merchant, processor, user; the red line for swap dealers; money managers is the blue line; and other reportables that are traders that are non-commercials, but have positions above the reporting level is the purple line. And you can see from the gold net futures and options combined, the largest shorts are in the producer/merchant category. Turning to silver, that pattern repeats, the largest shorts are in the producer/merchant category. And then turning to copper, generally that pattern repeats. And again, this would be for COMEX, for copper trade in the U.S.

Another way that we provide transparency to the public is through the Commission's Participation Report that's published on a monthly basis. Because we publish this on a monthly basis, we include data less frequently to the public than the weekly commitment of traders.

We publish the bank participation report where there are five or more banks in the market. These are divided into two categories of U.S. banks and non-U.S. Banks. If either one of those categories have less than four, then we do not publish the count of banks in the category. And generally you can see from the light red bars the leading short participants in these markets are

U.S. banks.

I'll look briefly at silver. You can see the same pattern. And then I'm going to skip ahead for a few slides. These are, again, on our web sites. And I want to look at an overlay of the commitment of traders in the bank participation report. This is an example of how one might use the reports together. And what I've done is, I've replicated the bank participation report, and I show four red bars for each report, typically because the BPR only comes out monthly. And it's been widely inferred and reported that there was a dramatic increase in short open interest towards banks in August of 2008. However, you can see from the full categories and the commitment of traders, there's not a likewise jump in any one of these categories, and likewise, there wasn't a significant change in open interest in the marketplace.

There are some alternative explanations that are plausible, and I'll offer two. And again, I can't comment on the specifics. One would be that the change in sort open interest could have occurred because of a reclassification of a trade in category from a non-bank to a bank. Another would be because of a merger or an acquisition where a bank assumes the position of a non-bank entity and they're both in the same category.

We also provide data to the public, a quarterly call currently, and we're going to move to a monthly basis, a special call in general. The special call data shows that the metals part of the index investment activity in the swap market is small in comparison to the energy markets. The last set of data is a quick look behind the public disaggregated commitment of trader's data. This has otherwise not been revealed to the public.

The summary of traders at or above position accountability levels for that sample period of the last two calendar years through March 16th, it's 115 different Tuesdays, and you can see quickly for gold, there were 56 different unique traders in all months combined that had a position over, and the maximum number on any one day was 26.

We've graphed some of this data and provided it in the documents that we released on the web site. For the top four owners, the net long positions, you can see here the top line is for copper, gold is yellow, and silver is in silver color. We graph for comparison purposes wheat and corn on the Chicago Board of Trade, S&P 500 on the CME, and the energy commodities is in the format from the reference energy commodity proposed rulemaking this year.

And you can see from the next chart, which are short positions, that the largest concentrations on the short side of the market are in copper, gold and silver. And with that, I'll note that this last bit of data is at the owner level, not the trader level. So we consolidated all traders that are owned by a common entity. I'll be happy to answer any questions.

CHAIRMAN GENSLER: I thank both our

panelists' excellent presentations. Again, for the public, you can find these 25 charts and the other presentations on our web. I'd just like to ask the General Council a couple of questions and maybe one question for Mr. Sherrod.

But to the General Council, a question that's come up and it's been discussed by some individual Commissioners or CFTC staff, it may come up at this meeting, I note that some of the statements submitted by panelists today includes some specific allegations regarding market manipulation in the metals market, and so I'd like to hear from you to what extent it's appropriate for the Commissioners or the CFTC staff to discuss these types of issues at this meeting, at this time.

MR. BERKOVITZ: As you noted, Mr. Chairman, the purpose of the meeting is to examine the trading of futures and options in the precious and base metals markets and to consider position limits and related hedge exemptions on CFTC regulated facilities in those markets. As the

CFTC's rules recognize, it is generally inappropriate for the Commission and its staff to publicly discuss the details of any possible enforcement investigations in this or any other area. The Commodity Exchange Act also prohibits the disclosure, the public disclosure of any information regarding individual positions or particular market participants by name.

Accordingly, this particular form is not appropriate for the discussion of specific allegations of misconduct by specific parties and it's not what the Commission contemplated for the meeting.

CHAIRMAN GENSLER: So in light of these restrictions on matters that the Commission may address in a public forum, I think it's appropriate for me as Chair to request that the Commission and the staff and witnesses, when you're on the other panels, refrain from discussing specific allegations against specific parties.

COMMISSIONER CHILTON: Point of

clarification, Mr. Chairman. I mean I understand if we're not in a -- we can't comment on our investigation, and we don't want to jeopardize any of that, and so we may not want to ask questions, but are you saying that witnesses can't say what they want about these issues?

CHAIRMAN GENSLER: Well, I look to the General Council's direction, but I think the witnesses --

COMMISSIONER CHILTON: Serve an intrical part of this whole issue.

CHAIRMAN GENSLER: -- should refrain from discussing specific allegations of specific parties; there are other venues to do that.

COMMISSIONER CHILTON: But we're not -- I'm sorry, I don't mean to interrupt.

CHAIRMAN GENSLER: There are other venues to do that with our Division of Enforcement, I think.

COMMISSIONER CHILTON: We're not censoring our witness' testimony.

CHAIRMAN GENSLER: I don't think I'm

suggesting that in any way.

COMMISSIONER CHILTON: Okay, that's all. Thank you.

CHAIRMAN GENSLER: I'd also like to ask the General Council, if you might, to comment upon a statement that was in the testimony submitted by the CME Group today. Hi Jerry. But in the testimony, which I think is being presented by Mr. LaSala on our second panel, the CME states that in order for the CFTC to impose position limits under the Commodities Exchange Act, that the Commission actually is required to, "to find", and this is from their testimony, I understand, "to find that, one, there is, in fact, excessive speculation or that it is likely to occur in the metals, and two, position limits are necessary and will diminish, eliminate or prevent the burdens of such speculation before it may impose position limits. No such finding has been made, therefore, imposing limits would exceed the Commission's statutory authority"; I think I quote from their testimony.

So I'd like you, as General Council to

this Commission, to tell us whether you agree with their interpretation of the Commodities Exchange Act, does the Commission have to make a finding that, in fact, there's been excessive speculation in order to impose position limits.

MR. BERKOVITZ: Thank you, Mr. Chairman. First of all, I would just note as a factual matter that the purpose of the hearing is to gather information, and no findings have been made. But in the abstract, whether a finding would be necessary, an actual finding that there has been excessive speculation or an actual finding by the Commission that there have been particular undo burdens, our interpretation of the Act is that a specific finding that there actually has been excessive speculation is not a necessary predicate for imposing position limits. But I would add that that's not just the current Office of General Council's view, that is the view that the Commission has actually adopted and the Commission has stated as the basis for its rulemaking on position limits.

The rulemaking I mentioned in my testimony in 1991, where the Commission determined that the exchanges should have position limits for all the commodities that did not already have Commission imposed position limits such as the agriculture commodities.

This issue was specifically raised in that rulemaking proceeding, and the Commission specifically addressed that very issue, that a number of commenters had raised a very similar comment back in the 1981 rulemaking questioning the Commission's authority.

At that time, I just quote briefly from the previous rulemaking, "The historical and current reason for imposing position limits on individual contracts is to prevent unreasonable fluctuations or unwarranted changes in the price of a commodity which may occur by allowing any one trader or a group of traders acting in concert to hold extraordinarily large futures positions. This regulatory philosophy is a well established precept underlying the Act. From the earliest days of federal regulation of the futures trading industry, Congress recognized that position limits could be an effective regulatory tool to prevent desperate market fluctuations." The commenters raised the very same comment in that rulemaking that the Commission hadn't made the actual finding that its excessive speculation has caused these burdens. The Commission's response was the Congress made the finding in Section 4A1. Section 4A1 represents an expressed congressional finding that excessive speculation is harmful to the market, and the finding that speculative limits are an effective prophylactic measure.

So Congress has said that the position limits already are an effective prophylactic measure, and such -- and gave the Commission the discretion when the Commission says we believe these particular position limit is appropriate to -- as a prophylactic measure.

In many of the rulemakings, I haven't gone through every one, in the 1990's, and subsequent revisions on various rulemakings, the

Commission has included a very similar statement that Congress has found position limits are an appropriate preventative measure, obviously in advance of some harmful excessive speculation into the commodity markets. Also in the 1981 rulemaking, the commenters said, you haven't demonstrated these particular levels or actually the levels that are absolutely necessary to prevent excessive speculation. And the Commission had basically the same response, that we do not -- the Congress has set up a scheme where the Commission has to find they're reasonably necessary, you don't actually have to prove the specific numerical levels.

Finally, I would add, I think as you noted in your earlier comment, Mr. Chairman, when we're talking about, for example, in the context of energy and metals, we're talking about reestablishing fixed Commission set position limits. This would essentially take it back to possibly -- to the situation where it was in the 1980's, before we had position accountability.

But currently, under the same regime, under the same statutory authority, there are spot month limits and there's position accountability. The spot month limits and the current position accountability levels derive from the very same authority that we're talking about here, so those are not -- do not have those specific findings currently either. So we believe that there is adequate authority.

CHAIRMAN GENSLER: All right. I thank you, and I apologize to Mr. Sherrod, but I'm going to hold my question and turn to my fellow Commissioners. We do actually have this little red light thing, we're trying to do this in five minutes, but Commissioner Dunn.

COMMISSIONER DUNN: Thank you, Mr. Chairman. Don't worry, I'll give Mr. Sherrod his fair share. It's tough following the Chairman because he asked some of the questions that I was going to ask, so I don't know if that speaks well of you or ill.

CHAIRMAN GENSLER: It just means we're a

good team, Mike.

COMMISSIONER DUNN: Okay. Mr. Chairman, I would note that in the briefing books that the staff gave us, there is an excellent chronology of speculation limits for COMEX and NYMEX on the -- delivered metals futures contracts. If that is not on the web site and there's no proprietary information in there, I would certainly hope that that could be put on the web site, as well, so the public would have access to that. I think they would find that very helpful looking at that entire history that our Chief Council began to enumerate.

CHAIRMAN GENSLER: Is that a yes?

MR. BERKOVITZ: That is in the written -- longer written statement, plus it's graphically displayed in the --

CHAIRMAN GENSLER: So if it's not yet on the web site --

MR. BERKOVITZ: It should be.

CHAIRMAN GENSLER: Thank you.

COMMISSIONER DUNN: Mr. Sherrod, we're

talking about the 4A that the General Council elaborated on, and it -- again, the CME contends that the Commission doesn't have the power to set position limits unless there is, in fact, excessive speculation or it has likely to occur, that's the prelatic side of what you were talking about, Mr. Berkovitz.

The statute loosely defines excessive speculation as that which causes sudden or unreasonable fluctuations or unwarranted changes in price. Mr. Sherrod, has DMO seen this type of fluctuation or change in the metals market?

MR. SHERROD: Once again, you ask tough questions. The price of metals has been quite volatile, particularly in 2008, and I would respectfully decline to comment. As you mentioned, there is an investigation underway.

COMMISSIONER DUNN: I would have preferred a simple yes or no. On page 13 of your written testimony, you go through the summary of traders at or above positions accountability levels, and you enumerate the single month, all month combined for gold, silver, copper of what's happening there. Please tell the Commission and the audience here, what does DMO do when someone exceeds their accountability level, and what does the exchanges do, and is there any definitive written guidelines, or is there a codification of how we interact with an exchange when we insert this?

MR. SHERROD: In DMO, we use our large trader reporting system, and we began gathering data on traders through a special call, and we provide the trader with a form 40 and gather information on the traders far before they reach the position accountability level.

We monitor their positions on a daily basis through the large trader reporting system in DMO. When a trader does equal -- their position equals or exceeds the position accountability level, the exchange automatically gets the consent of the trader to get information, and that would include traders that are non-members. If the trader is so ordered by the exchange, the trader is not allowed to increase their position further, or the exchange could order the trader to reduce the position, and that's without declaring an emergency.

On a regular basis, surveillance staff in DMO and surveillance staff in the reporting markets share reporting information and surveillance activities, so we do work hand and glove with the exchanges.

COMMISSIONER DUNN: Is that codified in any agreement with the exchanges?

MR. SHERROD: It's not codified in agreement, it's a work in practice.

COMMISSIONER DUNN: So, in essence, you're telling me al of these -- when they went over the position limits, all of these were, in effect, sanctioned by the CFTC, is what you're telling me?

MR. SHERROD: On page 13, we discuss the position accountability levels, and the -- the traders don't need any particular authority or approval for why the exchange or the CFTC to exceed the position accountability levels. On the other hand, for the spot month, which are hard limits, the exchange has shared their exemptions with us, the unshared. There currently are five exemptions in each of gold and silver, and there are fewer than four in copper, and we have those specific exemptions that we get on a regular basis from the exchanges.

COMMISSIONER DUNN: Again, my question, and let me zero in on this, because you're telling me that DMO is monitoring this on a real time basis, and that when you observe that someone has gone over an accountability level, not even -- before the position limit on the spot month, that you take actions on it? That tells me that, in effect, you have sanctioned what's going on; it that -- am I being misled on that?

MR. SHERROD: I want to try to be very clear. When a trader exceeds -- equals or exceeds a position accountability level, DMO surveillance staff does not do anything in particular. The exchange gathers information from the trader, it's their rule book that allows them to gather additional information.

We've gathered information from the trader at a much lower reporting level, when they exceed the reporting level. And as the exchange gathers information, we can obtain information that the exchange has. We don't do anything necessarily when a trader equals or exceeds the position accountability level.

COMMISSIONER DUNN: My time has expired.

CHAIRMAN GENSLER: To sort of clarify, it's really the exchanges that work with these accountability levels. We're aware of it, but you're saying DMO, this agency doesn't do something. Commissioner Sommers.

COMMISSIONER SOMMERS: Thank you, Mr. Chairman. I'll continue on the same sort of line of questioning with Mr. Sherrod. And maybe you can give us an idea and the public an idea of what a trader -- what would justify a trader having these positions over accountability levels?

MR. SHERROD: The trader doesn't have to

justify a position above a position accountability level. Their justification is only required when they're seeking an exemption from the spot limit, that's the hard limit.

COMMISSIONER SOMMERS: And to get those exemptions, if you could give us some examples of what -- how traders justify those exemptions.

MR. SHERROD: There are a variety of exemptions that would be available. The most typical example is for a bona fide hedging position consistent with Commission Regulation 1.3Z2, where the trader holds a cash position in gold or silver, for example, and will take a short position in the futures contracts to hedge the price risk, holding that physical inventory.

COMMISSIONER SOMMERS: Thank you.

CHAIRMAN GENSLER: Thank you, Commissioner Sommers. Commissioner Chilton.

COMMISSIONER CHILTON: Mr. Berkovitz, you mentioned the -- well, Mr. Sherrod mentioned the bank participation report, but I wanted to ask Mr. Berkovitz or counsel about it a little bit.

We have this dual issue that we have to balance, where we have Section 3 which says that we should promote price discovery, and then we have 8E of the Act that says that we can't reveal any individual trader.

This decision to not list all four, you know, concerned me, and it wasn't something that the Commission as an entity made a decision on. I'm not an attorney, so I can't talk about litigation risk. Everything else tells me that making this less transparent, this report, was not a good thing. But can you explain the sort of legal reason why you've chosen to do that?

And again, maybe this doesn't factor into it, but particularly at a time where we're talking about doing something on position limits, and where, if we've learned anything from the financial fiasco the last several years, it's that we need more transparency. So I'm just curious why we did this on a staff level, change this report.

MR. BERKOVITZ: The statutory -- you

correctly referred to the statutory section, Section 8A that prohibits the disclosure of positions or business transactions, and the statutory provision that prohibits the Commission from disclosing those does not -- it's not a balancing test, it's would attempt to disclose or not. And so we do not -- in reviewing whether -- what limits could be placed on -- or whether there should be limits or what information is appropriate to release, there's a certain boundary that the Commission is not -- can't cross, it's not a balancing test, and so we look at that as strictly for that purpose.

COMMISSIONER CHILTON: Okay, thank you. So, Mr. Sherrod, I mean doesn't it tell you that it's so large that it's going to reveal who the trader is, that maybe that should peak the Commission's interest? By the nature of having to make such a decision, doesn't that tell us that maybe there's an issue here that the Commission should consider?

MR. SHERROD: I think the answer is yes.

COMMISSIONER CHILTON: Okay. I'll accept that. All right. So I want to -- you can comment later if you want, Mr. Sherrod. So I want to commend you for your presentation. We get these -- we are privy to these sorts of presentations all the time by you and your staff, and they're very good and professional. Sometimes I feel like I'm a little -- like that song says, blinded by science, but today it was very good, and you're always very helpful.

I was particularly pleased to see your accountability level chart and what it shows and what Commissioner Dunn and the Chairman and Commissioner Sommers are saying is, you know, they're infectional. I mean they don't -- I've said before, they're like speed limits on a dark desert highway, they just -- there's nothing to be done, and I think we should do something, which is why, in my view, we need mandatory hard cap position limits.

If you go over them, you're in violation; if you continue to go over them, then there's some sort of action, some sort of -- there's a fine or a punishment or something. I don't know what that level is, and that's one of the things I'd like to ask some of our witnesses later about. I am curious, Mr. Sherrod, about -- a lot of people write to us, and people will talk about it later today, about the physical side of this. I know that we look at the physical side to some extent, but the shortages that people have talked about, and then I'm going to let you talk, but the second part of my question is, over the last couple of years, and before you were in this position also, I've given individual emails, some of it actually forecast the market in silver and in gold will plummet, that it's going to happen, and they'll say look at 9:00, Paul Caplan, Andrew Maguire and others have said this sort of thing, so I wonder if those have been helpful and if you can give a general characterization, without getting into any specific example that may jeopardize anything that the Commission is doing, but if you can generally characterize if those have been helpful and how you've looked at them.

So two questions, the physical shortage and the examples that we've been given by individual traders that have been looking at these markets for years and years. Thank you.

MR. SHERROD: I'll turn to the second one first. I always welcome comments from the public that would like to draw our attention to a particular matter. We investigate quite carefully, we have position data day by day and contract month by contract month for both futures and options at the individual trader level. That's the information we share with the Commission in the closed surveillance briefings each Friday. And as you know, we have looked at numerous complaints and looked at the trading intra day and examined those particular instances.

I can't comment further on the results of those or else I would be revealing, as Dan said, the positions or strategies of individual traders. As to whether there's a physical shortage in terms of supplies that are available in warehouses, we have not seen any difficulties with the delivery process in recent years.

CHAIRMAN GENSLER: Thank you, Commissioner Chilton. Commissioner O'Malia.

COMMISSIONER O'MALIA: Thank you. Mr. Sherrod, you did a great job in outlining the global nature of these markets. Can you give us an example of how these things are traded priced on a daily basis?

MR. SHERROD: Well, for example, on a daily basis, the -- I'll probably get the names slightly wrong, but I think it's the London Silver Market Fixing Limited conducts that daily survey led by the chair, and there are three banks in that group, and they go to customers and they discover a clearing price, and that price, for example, is used for cash settlement by the due by silvers futures. If someone takes a cash settlement option, they're making or taking physical delivery. So some of those price discovery mechanisms that are in place around the world are widely viewed as reliable and used as a basis of commercial transactions. And price discovery occurs in COMEX certainly, and around the globe in the visible and public trading markets.

COMMISSIONER O'MALIA: Could you also touch on the relationship to ETF's and the rise in their investment in those classes of funds?

MR. SHERROD: Well, ETF's provide a mechanism for, at least the ETF's that we're familiar with, for holding physical gold by the ETF and for a small investor to buy a share in the ETF. As the small investors make their independent decisions to buy shares, the ETF responds by buying the physical metal. And likewise, as the individual investors make their decisions to sell their shares, the ETF responds by selling the physical metal.

So they are linked through arbitrage to our markets, but those particular ETF's, the leading ETF's in gold and silver in particular don't hold futures contracts.

COMMISSIONER O'MALIA: Do you have any

concerns about their investment strategies and the relationship to futures markets?

MR. SHERROD: I think it's important to know that the ETF's that I've mentioned, the ones that are actually holding the physical gold and silver -- don't have an investment strategy, per se, other than to match their investor's demands in shares with holding of the physical metals.

CHAIRMAN GENSLER: I just wanted to ask one -- thank you, Commissioner O'Malia. Just for Mr. Sherrod, page, it's 17, it's this one, so I don't know if they're different numbers. But I just wanted to clarify, the green line on here is from one set of reports, our Commitment to Traders reports that come out weekly, and it suggests that there's 40 to 60 short in the producer/merchant category. The blocks are from a monthly report that labels things differently, and it suggests that the short give or take 40 on this is in the banks.

So am I to take -- I mean sometimes we think of banks as swap dealers, and in this case it doesn't line up without getting any particular names, but is there -- could you just help the public and the Commission understand?

MR. SHERROD: Sure, and I'm going to do this very generically, as you mentioned, without getting names. Banks have for very long periods, decades, been very active merchants in gold and silver, and, for example, the five members of the London Gold Market Fixing Limited that publishes the two daily gold fixes that are publicized on the London Bullion Market Association are Bank of Nova Scotia, Barclay's Bank, Deutsche Bank, HSBC Bank USA, and Societe Generale.

The three banks in the London Silver Market Fixing Limited are Bank of Nova Scotia, Deutsche Bank, and HSBC Bank USA. So there's a long history of banks being involved in the metals markets.

CHAIRMAN GENSLER: As merchants, you're saying?

MR. SHERROD: As dealer merchants.

CHAIRMAN GENSLER: I see, okay. I

didn't have any other questions. I don't know if any of my fellow Commissioners have any. Not seeing any other questions, I want to thank our panelists. And if our -- I think it's officially our second panel could come up, we would greatly appreciate that. There will be a break after this panel, I was just checking.

(Pause)

CHAIRMAN GENSLER: Each of you, I know you have written testimony that's going on the record, but if it's a chance to sort of summarize in five minutes, that would be really helpful so that we could get to some questions. There will be those lights over that help out -- no, it's right here on the panel. And I hope that's not rude of us, but you'll see that happening.

I'm just going to go from left to right. But Tom LaSala from the CME Group has I think testified before us, but -- we see you so often, Tom, I'm not sure.

MR. LASALA: Not specifically before the Commission.

CHAIRMAN GENSLER: All right. Well, then it's terrific to welcome you here for the first time testifying before the full Commission. I hope you come away feeling it was terrific, as well.

MR. LASALA: I hope so.

CHAIRMAN GENSLER: And then -- I'm just trying to read, because my glasses aren't good, but Jeremy Charles from HSBC, who's global had a precious metals for HSBC, and I thank you so much for taking the time to be with us. Mark Epstein, who is an individual trader in these markets and has a long history of trading on COMEX, NYMEX, and CME, and CBOT on various activities, but has been very active in metals markets. Jeff, if you can help me with your last name, just so --

MR. BURGHARDT: Burghardt.

CHAIRMAN GENSLER: Burghardt, Jeff Burghardt, who's the Vice President, North American Metal Procurement of Luvata Buffalo, but this is a global manufacturer, the public may not be as aware of, but global manufacturer in the copper based products and has over 6,000 employees, 30 production facilities in 18 countries, so it's very helpful that you're here today. And then, just turning to my notes to myself, but then we have, and you're going to help me with your name so that we don't --

MR. O'HEGARTY: Yes, Chairman; it's Diarmuid O'Hegarty.

CHAIRMAN GENSLER: All right.

MR. O'HEGARTY: Diarmuid as in --

CHAIRMAN GENSLER: What's that?

MR. O'HEGARTY: Diar as in deer, and mid, the U doesn't help at all.

CHAIRMAN GENSLER: Oh, all right, it's Diarmuid.

MR. O'HEGARTY: It is, yes.

CHAIRMAN GENSLER: O'Hegarty, who joins us as Deputy Chief Executive of the London Metal Exchange, that metal exchange that was being so discussed and is so central to these markets. He's been there for over ten years, first as General Council and Head of Enforcement, but was more recently, I guess now, a handful of years ago, promoted to the Deputy Chief Executive, which I guess would make you the number two.

MR. O'HEGARTY: I like to think so, yeah.

CHAIRMAN GENSLER: That's good. So I thank you, all our panelists. And I will just -- Tom, if you wish to start and we'll go across.

MR. LASALA: Thank you, Chairman Gensler and Commissioners for this opportunity to present our views on position limits and hedge exemptions for U.S. regulated exchanges. I'm Tom Lasala, Managing Director and Global Chief Regulatory Officer of CME Group, Inc. I'd like to take a few moments and make brief points and then be happy to take your questions.

First and foremost, excessive speculation of our markets and other metals markets has not occurred and is not a threat to orderly markets. Commission set position limits are not warranted by any subjective evidence. Second, the CME Group's position limit and accountability regime for a highly successful COMEX metals markets fully comply with our regulatory obligations under applicable core principals and users of our markets value our transparent and well regulated metals markets.

To ensure uniform understanding, allow me to describe that regime. We apply hard limits in the metals beginning the day before the delivery month. At all other times, we employ accountability levels. Each day, CME Group market surveillance analysts review their markets to identify entities over the accountability thresholds. On a weekly basis, a report is presented to market regulation management for additional review.

During the period from January, 2008 to February, 2010, our surveillance staff exercised authority, granted under the accountability rules on 28 occasions, and issued instructions to entities either not to increase their position or to reduce their position.

Additionally, the surveillance staff

monitors deliverable supplies in order to anticipate potential congestion or delivery problems. This regime fully complies with the CEA and Commission regulations and is administered by the exchanges with Commission oversight. Third, recent fringe complaints by organizations such as -- regarding allegedly depressed gold and silver prices are not supported by any credible evidence and lack any viable economic theory. Their claims are not representative of our broad customer base or value our well regulated and well functioning metals markets as compliments to the much larger and global metals cash markets.

Fourth, the supply demand inventory and available trading venues and instruments and the price discovery alternatives in the global metals markets illustrate that a futures market hard position limit regime and restrictions on hedge exemptions would have no positive effect or impact on the global price discovery process or world supply demand equilibrium.

Most likely restrictions in the form of

position limits on significant traders on U.S. regulated markets would simply inspire a shift of volume from U.S. exchanges to instruments and markets beyond the Commission's jurisdictional reach.

For example, the volume of copper futures contracts traded on COMEX in 2009 was only seven percent of the volume of copper futures contracts traded globally. Platinum futures traded on NYMEX in 2009 represented approximately 40 percent of the volume of such contracts traded on exchanges world-wide. A cash forward in ETF markets have taken over a major market share. And with respect to gold, for the three year period ending January, 2010, the number of ounces of gold actually delivered between clearing members on the LBMA system far exceeded the volume of gold traded on COMEX, with the exception of November, 2009 and January, 2010.

The gold traded on LBMA dwarf's contracts of gold traded on COMEX. And I note that the numbers on LBMA are net deliveries, they are not the total volume that is traded throughout a trading session.

Aside from the loss of business to U.S. Companies, any policy that moves trading off regulated markets conflicts with the Commission's stated goals of strengthening market efficiency and integrity. Moreover, such action would undercut the national policy of enhancing market transparency, a policy that was reaffirmed by Congress and amendments to the CEA in 2008, and is being pursued today by Congress' efforts to reform regulation of the financial system. Thank you, and I look forward to your questions.

CHAIRMAN GENSLER: Thank you so much, Mr. Lasala. Mr. Charles. Hold our questions and then try to do it as a panel.

MR. CHARLES: Chairman Gensler, Commissioners, and staff, my name is Jeremy Charles, I am Global Head of HSBC's precious metals business. I would like to extend my thanks for the opportunity to join this panel today and to share some views on the subject of potential limits and exemptions for precious metals trading on the U.S. futures exchanges.

I have worked in the wholesale gold and silver market for 35 years, and the global business that I manage today is a significant user of the precious metals products offered by U.S. futures markets, as well as other significant markets and exchanges around the world.

I have submitted a statement which I hope goes some way to describing how commercial institutions operate at an industry level and how participants such as HSBC use the futures markets as part of our every day activity in precious metals. We do believe that gold and silver are fundamentally different from the domestic agricultural commodities and from the energy products, and I trust that I have provided sufficient detail in my statement with respect to that. The fact is that the U.S. futures markets are an important component of the global precious metals trade. The liquidity and transparency they provide, along with the clear nature of the contract, is very appealing to the industry.

It should be remembered, however, that there are many markets around the world that could all provide similar services to the U.S. markets and which can quickly step in should inappropriate or overly burdensome restrictions be placed on the U.S. markets alone.

The free movements of liquidity among all of the global markets is a key factor in ensuring a level playing field for all participants, and it is the global trading, hedging and market making activities particularly by the wholesale commercial participants that aid in maintaining more orderly markets with better price stability notwithstanding local supply and demand attributes of individual markets.

This is a vital consideration for the Commission when discussing potential limits, and without the ability to freely trade and hedge, it may be the U.S. market that could find itself disadvantaged in terms of pricing and liquidity relative to other markets. HSBC, like other commercial institutions, frequently maintains open positions on the U.S. futures exchanges. But as you may know from previous inquiries, positions of this nature are typically hedged against positions established in other markets, particularly the London cash market.

If it wasn't for the ability of these commercial institutions to finance and warehouse physical cash positions in London, for example, which are then hedged against short futures positions in the U.S. market, then it may significantly restrict risk management activities, as well as the liquidity that would otherwise be available to investors seeking to establish and/or maintain long futures positions and economic rates.

As far as consideration for any exemptions, I cannot emphasize strongly enough the importance of the commercial participants in the U.S. precious metals futures markets. The U.S. futures markets for precious metals have gained a supreme reputation from participants as a fair transparent liquid and well regulated market, where rules covering large position reporting and accountability levels already fulfill the goals of regulated in terms of ensuring appropriate behavior by all market participants. I completely understand the need for the Commission to consider and investigate whether the implementation of additional limits is appropriate for each of the commodities markets. But certainly in the case of gold and silver, I believe that firm position limits are unnecessary, and were they to be imposed, it could be detrimental to the markets here in the U.S.

I have in my statement commented on concerns on the imposition of position limits and the application of exemptions and would urge the Commission, should you determine to impose any such limits, to carefully consider in detail clear exemptions for bona fide hedging, risk management and market making activities.

To summarize, the U.S. futures exchanges are but one of many choices that exist for investors, institutions, and users to deal in precious metals. The free movement of liquidity among these various global markets is a key driver in providing the world-wide previous metals trade with transparent, economic, fair, and liquid pricing. Thank you.

CHAIRMAN GENSLER: Thank you, Mr. Charles. Mr. Epstein. You might want to push the button, there you go.

MR. EPSTEIN: Thank you. Good morning, Chairman Gensler, Commissioners, fellow panelists. My name is Mark Epstein, and I'm an individual trader in the futures markets. Thank you for the opportunity to participate in this panel discussion. I trade nearly every business day in all of the active futures markets listed on the CME, including metals, energies, interest rates, agricultural products, currencies, and equity indices, and I'm a member of the CME, the CBRT, NYMEX, and COMEX.

I received a bachelor's degree in mathematics and a master's degree in computer science from the University of Chicago, and I've been involved in the futures and options markets for nearly 25 years.

Initially I worked as a technical analyst, researcher, and computer programmer, but for the past ten years or more, I've also been the trader. Currently I trade for my own individual account.

In all of the futures markets that I participate, I'm a market maker. I provide liquidity. I make two sided markets nearly all day long. Using computers, I'm able to quickly adjust my markets in real time to respond to changing conditions and to manage the risk that I'm taking. I'm a short term speculator responding to the ebbs and flows of prices, buying and selling, and I go home each night with either more money or less money than I started with at the beginning of the day. I tend to close out my position, so I rarely have overnight risk. Each futures market has its own individual personality, they all behave differently, and I know a lot about the personality of each of the markets that I trade. I place orders to buy and sell, working to make profit while avoiding danger.

Second by second or even millisecond by millisecond, I have decisions to make and orders to place. To me, the markets are a complex puzzle of moving numbers. But behind the scenes, the markets are actually real people, real products and real activities, especially in the commodities markets of finite supply.

Today I'm here to speak about the metals. I make markets in COMEX gold and silver futures, sometimes copper, as well, and I typically trade between 1,000 and 2,000 futures contracts in metals every day. I can tell you all kinds of statistics about the markets and the prices, but let's just take an example and look at 10:15 a.m. on February 4, 2010.

Somebody seems to have been in a rush to sell gold that day, and in less than a quarter of a second, they sold about 2,000 futures contracts, driving the price down instantly 100 ticks. This represents 200,000 ounces of gold, or about $250,000 worth of gold at the time. It was a very big trade and it took place in the blink of a second, in the blink of an eye.

There aren't many players in the gold market keep -- that big, and I'm not sure what motivated them to decide to overwhelm the price of gold instantly rather than selling more slowly, but this kind of thing happens in the metals market almost every day. Not even India's move to buy 6.7 billion worth of gold from the IMF on November 3rd created this big of a destruction to the action of the actual futures markets.

Today I'd like to speak primarily about COMEX silver. I traded silver for a few years, but I've only became particularly interested in it when I started to buy physical silver back in May, 2008. At that time, silver was trading at about the same price it is now, around $17 per ounce, but in between then and now, silver took a journey down to about $8.25 an ounce and visited a high of about $19.50 an ounce, and I traded every single price in there.

The futures markets for commodities of finite supply are very interesting and to maintain their integrity, there must be a tight relationship between the futures prices and the physical prices. This attracts speculators to participate and develop an effective marketplace for price discovery, which is -- bona fide producers and consumers of physical commodities to hedge the prices in their businesses. I followed the price of COMEX silver futures and the prices of physical silver market. Near the end of 2008, there appeared to be a divergence taking place between the price of COMEX silver futures and the price of physical silver.

So I bought some silver futures and I took physical delivery of thousand ounce bars from the CME, melted them into 100 ounce bars and sold them in the retail marketplace. This price divergence lasted for a couple of months, and I wasn't the only one who noticed. The warehouse stocks of physical silver COMEX dropped about 20 million ounces as people realized the cheapest way to get physical silver on the planet was by draining the inventory from COMEX.

Currently the COMEX silver warehouse stocks are down to about 115 million ounces. The accountability limits of COMEX silver or 6,000 contracts are 30 million ounces, but the delivery -- 1,500 contracts are seven and a half million ounces. I believe this is too high. Initially, the current open interest is about 114,000 contracts or 570 million ounces, almost a year's worth of mining production. From the commitment of trader's reports and the bank participation reports, it appears that the largest single position is held by a bank on the short side, and the size of that position is currently about 30,000 contracts or 150 million ounces, which is about 120 million ounces larger than the current accountability limit.

Presumably, they must have been granted an exemption to the position limits, but it seems wrong to me. Exemptions should only be granted to bona fide hedgers. In studying the micro price move in personality of the COMEX silver market, I can tell you that it behaves like no other market. The typical available liquidity in the deck is tiny, yet we have average daily volumes in excess of 40,000 contracts.

And as a result, there is significant price volatility for the market to absorb large orders. The existence of oversized market participants has a chilling effect on the market makers, which results in even less liquidity as market makers widen their prices to compensate for the increased risk they are taking, including myself. Consequently, the large orders wind up setting the prices rather than the proper function of futures markets to discover prices. The size of the open interest in COMEX silver is irresponsibly large given the reality of world inventories and production. Initially, there is a significant imbalance between largest long positions and the largest short positions, with the short being heavily concentrated.

And a physically delivered futures contract for commodity finite supply also exposes the marketplace to an unnecessary risk of failure to deliver at the COMEX. Such an event could destroy the COMEX silver market.

I'm encouraged with the CFTC's stated intention to implement a consistent policy for position limits in all commodity markets of finite supply. For COMEX silver, I think the position limit for all markets should be reduced to 2,000 contracts, with delivery limited to 1,000 contracts. And most importantly, exemption should only be granted to bona fide hedgers. Thank you.

CHAIRMAN GENSLER: Thank you, Mr. Epstein. Very interesting testimony. I like the part, some days you go home with a little bit more money and some days a little less money. Mr. Burghardt.

MR. BURGHARDT: Thank you, good morning. First, Mr. Commissioner, fellow Commissioners, I'd like to thank you for the invitation to talk today. I am Jeff Burghardt, Vice President for

Luvata, but I am testifying today on behalf of the Copper and Brass Fabricators Council, and we appreciate the opportunity to present our view in this matter.

The Council is a non-profit membership trade association whose members produce over 80 percent of all the copper and brass products made in the U.S. Absolutely critical to the Council members is the available of copper units at commercially viable prices.

In the last several years especially, the copper market has been subject to previously unprecedented fluctuations. The Commission's open meeting today to consider futures trading in the metals market is timely. It is our belief that investment funds have been the major driver behind the record high prices we have seen in many commodities in recent years, including copper, the primary raw material in our business.

These high prices, which we do not believe are warranted based on fundamentals, have caused major challenges for our industry, including increases in working capital and even more damaging substitution. One only has to look at the copper industry to see the disconnect between fundamentals and price. Since January of 2009, the price of copper has increased over 100 percent, while at the same time, the quantity and material stored in warehouses has also increased over 100 percent. Thus, while the copper market was in surplus, the price more than doubled.

Because of these high prices primarily, but also the high volatility, we completely support the CFTC in taking action to reduce the influence of investment funds in commodity markets. Commodity markets were established to be the benchmarks for determining prices for the underlying commodity. This has always been and we believe should be their primary function. However, today it seems as though they have become primarily investment vehicles, with prices many times have little correlation to cost or fundamentals.

We believe that if funds were to have

smaller positions in the markets, it would greatly reduce the volatility, bring prices more in line with fundamentals and cost. These results would be beneficial to our industry, our customers and to the academy in general. However, while we completely agree with the Commission that this situation warrants careful attention and we would like to see action taken, we'd like to offer a different method to accomplish this goal.

We feel the method you are proposing would be very challenged to implement effectively. The questions that you sent out on position limits highlight the complexity of this method, issues such as developing quantitative methods. A percentage or a fixed number of contracts, spreads, trades, exemptions, et cetera, highlight the complexity.

In addition, if limits were set high enough, they could impact -- it could end up impacting few, if any, firms. We'd like to suggest the CFTC consider a different approach to this challenge. It is our belief that imposing significantly higher initial margin requirements for investment funds would be a more effective solution.

While imposing position limits would potentially affect a few large funds, if any, raising the initial margin requirement would affect all investment funds immediately. While imposing position limits could achieve a goal of reducing speculation, we see higher margins as a better solution. Raising the initial margin offers several advantages. First, a system is already in place, funds are speculators that are already charged a higher amount for initial margin than hedgers or manufacturers. The fact that the system in place and being used today offers a significant advantage of implementation and should minimize any confusion.

The approach should also be much easier than position limits to monitor and control as it eliminates the deal with many of the questions that arise when trying to manage position limits. Again, this change would immediately also effect all funds across the board regardless of size. This is another advantage compared to position limits.

For these reasons, we feel that increasing initial margin amounts charged to investment funds or speculators will be a more effective solution to the problem. However, in any solution that is implemented, we would not want to see position limits put on hedgers or see initial margin change for this group either.

Futures markets are critical for us to use in establishing prices and being able to manage the price risk in our business. We only use futures markets as necessary in our day-to-day business to protect or to hedge our price risk, and it's critical we can do this in a cost effective manner. In summary, lower volatility in prices that reflect over time the real supply demand situation, not the excesses of speculation, would both be very beneficial to our industry. We fully support the CFTC in looking to limit the impact of investment funds and commodity markets, however, we would appreciate your consideration of using initial margins as the approach to accomplish this purpose.

However, regardless of the approach taken, the copper invest advocators would -- council will be glad to work with the Commission if we can be of any assistance in developing effective solution, and we appreciate being able to be here today on this important topic. Thank you.

CHAIRMAN GENSLER: Thank you, and Mr. O'Hegarty.

MR. O'HEGARTY: Thank you, Chairman, thank you, Commissioners. I've very grateful to be invited to give evidence here today. I've been asked to briefly give a picture of the London metal exchanges across the market, and I've provided slides and various information, but I'm not going to talk you through them because it'll take too long, but we can talk about them later. The London metal exchange operates futures and options markets in seven industrial base metals, alum -- copper, zinc, lead, nickel, tin and alum -- These are mature markets where the daily LME official prices have become the accepted reference prices for the world trade in those metals. Copper has been traded on the LME since 1877. Today the LME copper market has delivery locations in the U.S., Europe and Asia. The slide that I've provided give a picture of the physical nature of the LME contract.

For example, copper -- that a good delivery against the LME contract represent 59 percent of the world's production capacity in 2009. The LME is an unexchanged forwards market. Each LME futures contract is an obligation to deliver metal against payment on the settlement date.

On a trading day, the available settlement dates are every business date after three months, every Wednesday after six months, and every third Wednesday in the month up to ten years.

Settlement of LME futures contracts is

first by offset and then by delivery of the balancing positions by means of LME warrants. This takes place on the settlement date, so ownership of metal changes hands on the day, there is no settlement window. An LME copper warrant is a bare warehouse facility that represents the ownership of a specific 25 tons of an identified producer brand stored in an identified shed operated by an LME approved warehouse company. The warranty to specify the number of bundles in the lot.

The slides show the volume of copper that was delivered in, stored and delivered at a -- approved warehouse sheds in 2009. The LME devotes a great deal of effort to maintaining the brand listing and warehousing systems because the reliability of metal stored in LME approved warehouse sheds underpins the integrity of the trading, and therefore, the price discovery.

An early settlement system means that anyone who does not want to or is not able to deliver a warrant against the natural position due to settle tomorrow has until 12:30 London time today to postpone delivering by rolling that position forward by a day. This is referred to as tom/next trading, i.e., tom for tomorrow and next for the next day.

The evidence of a settlement squeeze is the -- price that a short position holder has to pay to buy the tom/next spread. I've provided a copy of an LME notice that explains how the LME lending guidance protects the market from settlement squeezes. In effect, a dominant long position holder is obliged to lend to the short position holder by selling the tom/next spread at a fixed rate. I've also provided a slide that gives information on tom/next copper trading during 2009 and a slide that shows the number of times large positions appeared in open interest figures for each of the three months forward.

One last point, the LME receives position reports by 8:30 a.m. each morning that give the total positions for each broker and each of its clients for all settlement dates as of the close of business the night before. This allows the LME to have a total picture of the markets, to group together connected positions, and therefore, to apply the lending guidance.

The LME also, sorry, the rules also give the LME the power to ask for OTC positions if there are unexchanged positions that need to be explained. You have the slides, so if you would like me to go through any of them, I might. If I have a bit more time, there are three slides I think that, given -- picture. The arbitrage between the Shanghai futures exchange and the LME is not possible for most people to be a cash arbitrage. You need to physically take metal out of one and deliver it into the other. So slide one, sorry, slide four shows the LME's share of futures trade of copper over the year, and you'll notice it dipped in July, that means Shanghai futures trading increased. If you then go to slide seven, this shows LME stocks in warehouses over the period.

Now, one of the points is that the total stock figure at the beginning of the year and the total stock figure at the end of the year, but you also get the net deliveries in and out, and you can see that more metal went in and out than actually stayed.

But also, the interesting one, green is Asia, and during the July period, all -- there was no metal -- warehouses in Asia. That doesn't mean it wasn't going in, it was going in and coming out, but not staying.

And then finally slide 13 shows the tom/next trading and the -- where there was a small degradation. The tom/next trading is in July. That shows how to connect where the markets are. Thank you.

CHAIRMAN GENSLER: Thank you to all of our panelists for excellent testimony. I'm going to ask a couple questions and keep myself hopefully to my own five minute round. I had a question, it's probably to Mr. Charles and Mr. Epstein, but anybody have a view, and it's particularly around some of the slides that Mr.

Sherrod had earlier about the concentration in the precious metals markets, particularly in the silver market. But in comparison to the energy market, its slide suggested a more highly concentrated market, and Mr. Epstein said each of these markets have a personality.

And one of the slides even showed a particular concentration on the short side of the marketplace. So without, you know, going into individual trading strategies, but what's the nature of the market, particularly in the silver market, that these publicly available information suggests the large concentrated short side of the marketplace? Either Mr. Charles --

MR. CHARLES: Thank you. Of course, I'm in a position where I know what HSBC's position is, but I'm not aware of what everybody else's position is.

CHAIRMAN GENSLER: But you're in a position where you can share your views from the seat that you sit in?

MR. CHARLES: The positions in -- the

short future positions in -- on the futures markets, as I've mentioned in my statement, they are hedged against contracts primarily in the local London markets, certainly in our case. And the reason, you know, I can't comment on why there is such a concentration. We use the market as a mechanism -- as a hedging mechanism against our OTC, against our cash positions, and the reason we have cash positions is for a number of reasons. You know, we obviously trade in the market, we're a market maker, we're hedging client activity, and we also use the cash against futures positions to manage our liquidity positions.

So I need to be long of cash, I need to hedge that, so I'm short a futures, and I use those cash positions to provide physical services to our clients and also provide loans to our clients, as well. So that's the reason why we maintain such a position of that nature.

CHAIRMAN GENSLER: If I can just explore that, I'm sorry, but -- so if you're on the short side on the COMEX futures, the long cash position, is this a merchant? I mean is it that you're providing physical bars of silver and gold?

MR. CHARLES: Absolutely; so we maintain a cash position in London, which is in a physical bar form. London is a physical market. So we maintain a long position in the physical market. The reason we do that is so that we can provide our clients with the services that we supply to --

CHAIRMAN GENSLER: And is that largely bought silver then?

MR. CHARLES: Yes, it is.

CHAIRMAN GENSLER: So you're not sort of shipping it out and shipping it in, but it's --

MR. CHARLES: No; the metal is -- against the short position certainly that we maintain anyway, we hold metal in the vault in London.

CHAIRMAN GENSLER: I see. Mr. Epstein, did you have a view on this?

MR. EPSTEIN: Yes; the idea that, you know, if somebody has a big pile of silver and they wish to avoid price risk, then it's natural to sell silver futures, that's the role of the futures markets. If you imagine we didn't have futures markets at all, it would be terrible. The CFTC's role is very important, and the CME does a great job in providing liquid, highly active futures markets.

The issue in silver specifically -- I looked at silver yesterday, I traded it, and I was kind of curious, you know, were there things about the short concentration that came to the forefront yesterday, for instance. And there was one example, 8:37 and 53 seconds Chicago time; somebody decided to sell a little bit of silver, similar to how they sold 2,000 gold contracts, you know, back a few weeks before, and it only -- they only sold 272 silver contracts, and silver dropped, you know, 14 ticks, which is almost a half a percent, and that's only 270 futures contracts, but they did it in 50 milliseconds.

When you look at gold, you know, gold dropping 2,000 contracts, you know, one percent, you know, earlier, it's the size of these -- the capability of people, individual, whether they're banks, whether they're individuals, whoever they are, to take a risk position, to sell 2,000 futures. If somebody sold 2,000 futures in silver, it would be limit down instantly. I mean there's -- the market can't absorb that.

If there weren't these big monster gorilla traders out there in a market that that's small, there would arrive a much more robust market making community. The markets would be much more effective at finding prices.

CHAIRMAN GENSLER: Thank you. I just wanted to ask Mr. O'Hegarty a question. In December, the FSA -- you're regulated by the FSA?

MR. O'HEGARTY: Yes.

CHAIRMAN GENSLER: The FSA published something around over-the-counter derivatives -- I'm going to ask my question the second round, because I'll keep myself to the five minutes, but I want to ask you about your -- how they use position management authority in London, Commissioner Dunn.

COMMISSIONER DUNN: Thank you, Mr. Chairman. Mr. Epstein, I'm going to pick on you just a little bit here, not because you're a silver trader, but because you have a mathematics degree from the University of Chicago, which, in my opinion, is the epicenter of high frequency trading through algorithms, which is what you have, in essence, developed in your program. And you talk about the big monstrous traders out there; do you see somebody on the other side of you using a much more powerful program than you might have?

MR. EPSTEIN: Well, everybody that's trading in the futures market is buying or selling and there's a counterparty to every transaction, it's a fair game. If I make money, somebody else lost it, if I lose money, somebody else made it. The CME has a forum, you know, to allow buyers, small, large, to come in and out and place orders quickly, slowly, however they choose, it's a fair playing field, it's fico, you know, the first person who gets the order in, you know, trades with the first person who got the order in the other direction. So whether somebody on the other side of my trade is large, I'm primarily providing liquidity, which means that I'm willing to buy when customers or other people in the world come in to sell, and I'm willing to sell when customers -- people that need to use the market come in.

People that are providing liquidity are kind of the core, the core speculators to a futures market, whether they're in the pit years ago waving and yelling and screaming their hands or they're programming computers these days.

So I see it as a very fair market and I think it's crucially important. The problem is, if people come in -- I mean one person, you know, whether it's a bank or somebody that wants to, you know, throw $5 million around, $10 million worth of silver, can massively disrupt the market very, very quickly. The market itself is small as a result of the big players having the ability to throw around large size.

MR. BURGHARDT: If I could just make a

comment. My expertise is on copper, not silver, but he talked about, you know, the impact that these large players have. A little history on copper; if we look at 2002, copper moved -- less than 15 cents in the entire year, that was the range, from high to low, okay. Now we see ranges of 15 cents in a day, and it's the same thing in our market. Somebody comes in, takes very large positions in the trade, you know, which I'm representing today are not large enough to offset those positions, and you see volatility in a day that -- more in a day than you used to see in a year.

COMMISSIONER DUNN: Mr. Epstein, back on your program, and you talk about the three milliseconds that you might have as the heads up on something, are you co-located with your position?

MR. EPSTEIN: I am co-located at the CME. The CME has a wonderful program that's available to anybody to basically place their computers at a specified data center and get access to be able to buy and sell quickly, and it's available to anybody.

COMMISSIONER DUNN: Again, I apologize for picking on you. I just found your testimony so intriguing. We got, or I got a lot of letters, I imagine the other Commissioners did, as well, concerns about unable to purchase silver in the retail market at a particular time. You seem to be able to get around that by taking delivery. Is that something anybody could do?

MR. EPSTEIN: I was kind of curious about it, and it was really easy, you know. I bought some futures contracts, as I do all day long, but rather than selling them to a lock and a profit or loss that day, I noticed the exchange, that I wanted to take physical delivery. Once I took physical delivery, I coordinated to have a truck pick it up, they took it out of the exchange.

The metals that are sitting at the exchange, the 150 million ounces that are there right now, when I actually took delivery, nothing happened, they just gave me a warehouse receipt that said these are your bars and you can keep them there.

And everybody at the exchange and my clearing firm said, are you really sure you want to take these things out, because once you take those physical thousand ounce bars, each of them weighs about 75 pounds, off the exchange, if you want to sell them again to the, you know, on the futures market, you have to get them re-essayed to be able to put them back in the exchange legitimately, and it's an expensive process, so once you take them out, you got them, you know, you're not putting them back to sell in the futures market very easily. But I decided to try it out, and I took them, and I melted them, and I sold them in the physical market. And this really exemplifies how important it is for the futures markets to track physical markets. If you're trying to hedge your gold or silver, and the futures markets are mispriced by whether it's 50 cents, a dollar, or in that situation, $2 or $3, it's ridiculous. The futures markets are on longer serving their purpose. And everybody that noticed this and decided to take the initiative to try it out, you know, took physical bars at the cheapest that they could be found on the planet from the COMEX.

COMEX could have lost all their bars. They had 1,500, seven and a half million is the most ounces you can take in a delivery month, you know. A half a dozen people, seven and a half million ounces isn't that much for people, so they could have -- they could have drained it.

COMMISSIONER DUNN: I know my time is up, but it begs the question, what would happen if they drained the reserves at COMEX.

MR. LASALA: What would happen? I think, number one, Commissioner, I don't think it would drain the vaults in the COMEX. Number two, I think that if prices dictated that there was a high demand for metal, metal would come in to the COMEX vaults. Remembering back to that global market, you know, local, London, traders would see that arbitrage and bring metal in and replenish supplies. I'm not sure, quite frankly, what market Mr. Epstein sold his metal in, but I think, you know, someone questioned shortage, you know, in like a consumer chain, that's very different from the COMEX market.

There have been certainly, you know, I've gotten emails about individual investors saying this is, you know, I've got high prices for coins, how come the COMEX is so much cheaper. The answer to that is simply, we're not a coin market. There's all kinds of steps in between and handling and middle men to go from a COMEX bar to a finished coin.

CHAIRMAN GENSLER: Thank you, Commissioner Dunn, and I'm sure we'll keep following up on this. Commissioner Sommers.

COMMISSIONER SOMMERS: Thank you, Mr. Chairman. I'd like to ask Mr. LaSala if he'd be willing to comment on Mr. Epstein's testimony on how the markets work at COMEX, and if you could give us an idea of how they're comparable to the other markets you servile, especially the energy, the differences between how metals markets may compare to the energy markets.

MR. LASALA: Well, I think it's, you know, the first thing I'd say, Commissioner, is, you know, relativity, meaning that COMEX metals markets I think has -- some charts were up earlier by Mr. Sherrod, are not the largest in the world by far, so there's going to be a relationship between COMEX markets and world markets.

We're not going to, you know, I certainly am not saying we're not going to be a price discovery mechanism, because to many, you know, we certainly are relied upon, but we're not going to necessarily be the driver.

Furthermore, again, depending on the market, some of the energies are going to be more liquid than some of the metals, some of the metals are going to be more liquid than some of the energies. You know, for example, you know, gold is going to, broadly speaking, be more liquid than some of our smaller New York Harbor energy products. So they're all different.

The structures of these markets have, in effect, changed in some regards with the advent of electronic trading. I'm not sure if Mr. Epstein ever stood in the pit; if he did, you know, he's not standing there anymore. It just seemed that -- when NYMEX moved to implement electronic trading, at least in the futures markets, there was more of a move, you know, it moved pretty radically away from the floor, and that definitely I think had an impact on people that traded in that pit community, where, when you were standing in the pit, there was almost a swell, you could feel the market.

That sounds, you know, somewhat odd, but there was a certain feel that was obtained by being in the pit. There's no feel coming through that computer terminal anymore. So the market now is more global than ever. I'd like to say in many instances more liquid than ever.

In some regards, some of these markets certainly are more volatile than others. And generally speaking, the smaller the market, the more apt it is to be effected by orders in it. To his comment earlier about an event on a certain date, I don't know what occurred that day, was it someone putting in a large order in error when the book was particularly shallow, but that certainly can occur.

I wouldn't, however, conclude that that was necessarily linked to in any way parties that were -- that have "concentrations." So in answering your question, again, I think it's all a matter of, you know, relative standing between the markets.

COMMISSIONER SOMMERS: If I have time for one more question, I have another question for you with regard to the bona fide hedge exemption.

MR. LASALA: Sure.

COMMISSIONER SOMMERS: And if you could give us an example on either why you grant an exemption to somebody or why you wouldn't grant an exemption to somebody, and then on the other side, with accountability levels, why you may look at someone's position and decide that it's justified versus looking at somebody's position and deciding it's not.

MR. LASALA: Very good; I'll start with the hedge exemption. Obviously, applicable for the pendency of the front month, what we would be looking at, you know, with exemptions, and just to be clear to the Commission and to the public, this is not -- these exemptions are not granted just simply in a blanket capacity, meaning that it's not in gold where there's a 3,000 contract limit, you're exempted and you do as you please.

You apply to us and you stipulate to us, give us, you know, your book, so to speak, what is behind the position. And we don't grant that exemption, as I said, just open, it's going to be for a finite number. What we're cognizant of in granting that number would be, is the underlying exposure there, and number two, in granting that position limit exemption, have we created a concentration.

So I can give you examples, whether it

be in metals or in energies, where large entities, I have no doubt in my mind that they've got the underlying exposure that they're asking for the exemption, I just can't give them the level of exemption they may seek, because that size in and of itself could, in fact, cause a concentration, could, in fact, cause an anomaly in terms of pricing.

With regard to accountability, I think you know, and by Mr. Sherrod's presentation, those accountability levels are at historical levels, meaning they're very small. We kept them that way, I pushed to keep them low to, quite frankly, maximize my ability to reach in when I thought it was appropriate.

That stated, one of the key concerns that we seek to address in accountability inquiries is, quite frankly, around concentration. And I can tell you that, you know, we certainly, as demonstrated in the written testimony, and I mentioned my oral, and, you know, during a 14 month period, we documented 28 particular instances. Some of those would be certainly to commercial players, and I have to tell you that -- I would say that some of those commercial entities might not be pleased, because, again, they have the corresponding exposure, but I'm looking at a greater picture, that being just simply the orderly operation of the marketplace.

And to also just be clear and well rounded, in a given month, because that accountability level is low, we may have certainly checked out, you know, when an entity came in the market, who they are, what they are, what type of operation they conduct. They may be in excess of the accountability in a particular month, and the percentage of the marketplace is so low that other than the fact that we're always sensitive to activities in the market that could be manipulative or what not, that concentration doesn't pose a threat.

CHAIRMAN GENSLER: Thank you, Commissioner Sommers. Commissioner Chilton.

COMMISSIONER CHILTON: I want to thank

all of you for your testimonies. And before I start with Mr. LaSala, I just want to say I think the CME does a good job, we didn't have any major defaults during this economic fiasco, there wasn't a problem at your exchange or on the futures markets in general. So that said, it doesn't mean that we don't have issues, and I think there are some. You tell, as Commissioner Sommers was talking about, the accountability levels, and you note that you have taken 28 actions, and I want to make sure that everybody is clear. Those 28 actions, those weren't just in the metals complex, right, that's 28 actions in all of the contracts?

MR. LASALA: No, that's not correct, that was in the metals contracts.

COMMISSIONER CHILTON: Okay. Thank you, I'm glad I clarified it. And of those in the metals contracts, what you say is to maintain or reduce, so some of your actions were to say everything is copasetic. Do you have any idea how many of them were to reduce positions?

MR. LASALA: I can't -- I don't have

that information with me.

COMMISSIONER CHILTON: Okay.

MR. LASALA: I'll gladly supply it.

COMMISSIONER CHILTON: But maintaining -- well, they violated it, but it's okay, so whatever.

MR. LASALA: I'll be clear; when you say -- they didn't violate really anything.

COMMISSIONER CHILTON: Right, they didn't violate a thing, okay. So did you instruct any shorts to reduce their positions during that time?

MR. LASALA: I don't have those stats in front of me. My -- I will say --

COMMISSIONER CHILTON: No problem.

MR. LASALA: -- double check and circle back to you. My guess would be yes.

COMMISSIONER CHILTON: If there's no objection, if you'd like to provide that for the record, without objection, Mr. Chairman, is that appropriate?

CHAIRMAN GENSLER: Certainly, yes.

COMMISSIONER CHILTON: Okay.

CHAIRMAN GENSLER: If you feel comfortable doing it.

MR. LASALA: We'd be happy to subsequently submit it to you.

COMMISSIONER CHILTON: So were there any enforcement actions taken with anybody who violated these accountability actions, any fines that were levied?

MR. LASALA: There is at least one matter pending.

COMMISSIONER CHILTON: Okay. One matter pending, okay. So you took 28 actions in the metals complex, some were to maintain, some were to reduce, it may have been on the shorts, and there's one case. But as Mr. Sherrod talked about, in the last two years, we have an average of abrogations, that may be too strong a word, but examples of traders exceeding the accountability level, that's in gold, up to 28, for the average. This is the average time the traders are in -- I'll take your word, have exceeded the accountability levels four times, and at one point there's a maximum of seven.

So, you know, I think you can argue, people can make their decision on the merits of it, I think you can argue that, you know, from your perspective, the markets are okay, and maybe these levels don't impact and everything is all right. But to argue that the position limits are working, I think, you know, the statistics aren't on your side. Okay.

Mr. Charles, I'm curious, you mentioned exemptions, which I appreciate, and you talked about the need to legitimately hedge your business, your customers; can I take it from that that you would not be opposed to having an exemption that would restrict your ability to trade in excess of the accountability level or a position level for your own book?

MR. CHARLES: Sorry, can you just repeat that again, please?

COMMISSIONER CHILTON: Okay. You got an exemption, and your testimony was that you need such an exemption for your customer's account, to be able to cover their hedging. But would you agree that you, for your own book, for your bank, that you shouldn't be allowed to use your bank's funds, not your customer's funds, in excess of the accountability or position limits?

MR. CHARLES: Well, we use the -- we would use the exemption to satisfy the hedging of one contract against another, and I think I explained this. You know, we take positions in the futures markets that are equal and opposite to the cash market. I think that's a general misconception that there are large open short positions out there. Certainly the positions that we run are matched off against the cash contract, primarily the local -- contract.

COMMISSIONER CHILTON: You can only go -- accountability level or the -- for your legitimate business of your customers.

MR. CHARLES: The issue there is, what is the legitimate business for our customers, because, of course --

COMMISSIONER CHILTON: (off mic) -- from your own book?

MR. CHARLES: That would be extremely difficult, in my opinion.

COMMISSIONER CHILTON: Okay.

MR. CHARLES: It would be --

COMMISSIONER CHILTON: It could -- like I said, it might be a headache. If you could do it, would you be opposed to saying that you can't trade in excess of the accountability levels or position limits for your own book? It's a proposal that, by the way, is in our energy proposal to do just that.

MR. CHARLES: Well, I would find it extremely difficult to differentiate that, because, of course, you know, as I explained earlier, there is a reason why we do the hedging that we do, there's a reason why we hedge cash against futures, we need the cash positions to be able to service our customers.

COMMISSIONER CHILTON: All right. Well, I won't ask you about the Volkcer rule then.

Thank you.

CHAIRMAN GENSLER: Thank you, Commissioner Chilton. Commissioner O'Malia.

COMMISSIONER O'MALIA: I guess I'd like to follow up. Mr. Epstein raised a serious concern regarding the physical inventories inadequate to back-up short positions, and Mr. LaSala, you touched on that a little bit. Maybe we could get Mr. Charles, Mr. O'Hegarty to comment on that, what you think the -- might be.

MR. CHARLES: There's a slide from the gentleman who spoke earlier, Sherrod, there's considerably greater turnover in the London market than there is in COMEX. There is a massive amount of metal that sits in London's vault. It exceeds by some magnitude the stocks that are available in the United States, by some considerable magnitude. And any shortage of physical metal that has been mentioned a couple of times during this hearing, what's tended to happen is, there hasn't been a shortage of physical metal, there's been a shortage of one type of a particular product.

Physical metal is always available. If somebody wanted, you know, a million ounces of gold, you know, HSBC could supply that within 48 hours, it's no problem. But if you wanted a million make believe coins, for example, you might find that slightly more difficult to achieve. So the physical metal is always available, it's just the type of physical metal that clients actually need at the time they require it that has been the cause of some concern. Physical metal, there is a massive stock in London.

MR. O'HEGARTY: Thank you. I'd like to start by saying I do think there's a serious divide between the base metals and the precious metals in this, but the question about the copper stocks is, as I said, ours is a daily settlement contract, so there is no separation between the cash and the futures market.

People are trading right up to tomorrow. And you see the stock movements going through the stocks. Settlement is by a warrant, and our statistics are roughly five percent of all contracts result in a warrant changing hands, but of warrants changing hands, only five percent results in metal coming in or going out of a warehouse, and you still see the large volumes of metal going in and out.

So the worry that there isn't enough metal left to meet the trading is not how you would look at it. The trading actually reflects the available supply of physical metal in the market, and I think the figures I'm trying to give about breaking down say by location, one of the advantages of us having warehouse locations in the three geographic regions is that it does illustrate why there's shortage in one and not shortage in another, and it reflects industrial demand in one and not in the other. And in copper, I think the big news in the last eight years has been China, you know, how much are they consuming, what is their production capacity.

And I don't envy my friend, Jeff's job here, because he's competing with them for supply, but he's also competing with them for the pipes he's selling, because they're turning it into pipes and selling it. And, you know, this has been an issue in the copper market since then about is there a right price, and the answer is, that's the right price.

We've had debates with fabricators for a long time, because one of the issues in the copper market compared to say some of the other base metals markets is, there is more of a splitting between the producers as in those who have produced copper and those who fabricated.

Up until 2002, it was more common for fabrication to be the value added business, and therefore, separated out, and the traditions in the market are that you pay for your copper on the nail when you buy it, and yet you sell your pipes on 30 days credit, which when prices double up, it's not a great business model. But our role in all of this is to discover the price, and are our mechanisms designed to make that a fair discovery of the price or does it amount to be a manipulated discovery of the prices is my daily job, and I think that supply of copper is not one of the issues.

And I think we've put a lot of work over the past hundred and something years to try and learn from the various mistakes in the market over the years, and what we've ended up with is I think as good as it gets. Thank you.

CHAIRMAN GENSLER: Mr. Epstein, you want to -- I used you as an example, you're free to respond.

MR. EPSTEIN: Thank you. The calendar role in silver, like right now the May/July role is typically trading at about two cents, that's more or less the cost to store the silver, and it always trades more or less two cents. Last -- when we were in the situation where people were withdrawing physical silver from COMEX, it was trading ten cents the other direction, it was a massive move, and the perception -- and that doesn't happen by a few contracts. If you look at the market in the role, you know, it's often ten or 20 or even 30 or 40,000 contracts up, ten to the penny wide, so for it to move 12 full cents, and I'm not talking about an expiration moment, I'm talking about during the 30 days of expiration, something significant was taking place, and the issue was that the draining of physical metals in Chicago or from COMEX was actually an easier way to get metal than any other place on the planet. That shouldn't happen in the futures markets.

CHAIRMAN GENSLER: Thank you, Commissioner O'Malia. I'm going to allow another round because I had at least a question, but if you can work with me, keep your answers really short. So, Mr. O'Hegarty, I was just curious whether you're familiar with the FSA's, what they call position management approach, where they said, and this was in a public document in December, was their last week, and talk to them about it, that they work with the exchanges, not just your exchange, in what they call position management, not hard limits, but if one particular trader gets large or outsized or concentrated on the market, they sort of have a dial-up with you about it.

MR. O'HEGARTY: Yes; I'm afraid this is not me talking about us, because our market has the daily delivery and for the vending guidance is that tool. But on the physically settled markets in the UK, they tend to be monthly or bi-monthly contracts. So part because there's an issue about the commodities deteriorate over time. What they have is historic records of available supply in the settlement month, and all of these tools, including our lending guidance, are to guard against settlement squeezes.

So what they're trying to make sure is that enough supply to meet the spot month deliveries. And what they have is, they get information from the position holders, and once they reach certain levels, I think they're a bit like the things the CME run, is, they trigger a potential action.

And the rules of the exchange do allow them to force positions to be closed out. So that's how, in effect, they actively manage the available -- the positions leading up to delivery.

CHAIRMAN GENSLER: I take your answer is, you're familiar with their position management regime, though it's used on the other exchanges, and that they use it in a way to, as you said, to protect against squeezes in the delivery month?

MR. O'HEGARTY: Yes.

CHAIRMAN GENSLER: Thank you. I just had a quick question for Mr. LaSala. I noticed that the gold and silver markets currently have identical accountability levels, and the gold open interest, you know, is roughly five times the silver account. And I know they're historic numbers, but am just interested in why.

MR. LASALA: I think you hit it, Commissioner, Mr. Chairman, I should say, that it's just simply a historical matter. You know, they were down -- those are very, very low, and we found that they give us, relative to the open interest, lots of latitude that plays contrary to the point --

CHAIRMAN GENSLER: Okay. So it's just historic?

MR. LASALA: Historic.

CHAIRMAN GENSLER: My last question, because I've run out of time, again for Mr. LaSala, you talked a lot with fellow Commissioners about how often you talk to people over the accountability levels, and I'm just curious, how often do you talk to the large -- I mean there's, you know, from Mr. Sherrod's thing, there's -- the top four have very concentrated positions, how often do you talk to those particular traders that have the very concentrated positions?

MR. LASALA: I'd say to you where appropriate, and where necessary, and we -- I will share with you --

CHAIRMAN GENSLER: Where necessary, how often is that, is that daily, is it weekly?

MR. LASALA: No, it's -- no, it's not daily. If we, you know, have checked with them some months ago about the position and we know their business, so to speak, XYZ, Merchant Bank has typically, for queries we've made with them, maintained short positions, and they --

CHAIRMAN GENSLER: And you leave it alone?

MR. LASALA: We would leave it alone.

CHAIRMAN GENSLER: Mr. Charles, just quickly, on the physical long side, you say you're short futures and long cash, does that just stay in a vault, or do people actually deliver -- does HSBC deliver out and deliver in, are you dealing in that?

MR. CHARLES: Part of the clearing system in London is the regular deliveries in and deliveries out. Typically we maintain considerable inventory. You know, the London market is a primary settlement location for physical markets globally, so producers, for example, would deliver metal into the vaults for credit to their account, and consumers will take metal out of the vaults. The metal that we tend to up charge against the futures market will stay -- will be kept in a vault.

CHAIRMAN GENSLER: I think it would be helpful for this discussion, not only for the Commission, but for the public to understand that, because there's been a lot focused on the large concentrated shorts, and as you've described it, at least for HSBC, you have this long position there, and just whatever the business model is, just to have a little bit more transparency I think would be helpful to understand that. Mr. LaSala, because --

MR. LASALA: Thank you. Mr. Chairman, if I could just add, to follow up your -- the point you made earlier, we recently conducted a review of the large shorts in gold and silver, and I'd certainly be happy to share those results with the DMO folks at the conclusion of the meeting.

CHAIRMAN GENSLER: That would be terrific, thank you.

MR. LASALA: The results will be comparable to what we've seen in the past.

CHAIRMAN GENSLER: Thank you. Commissioner Dunn.

COMMISSIONER DUNN: Quick to motion there, Mr. Chairman. I think that -- I understand on the precious metal one, gold to a large part and to silver, that when times get rough, the dollar gets high, people say, we want to hold that as a hedge a bit, and people get gold and they keep it, they don't -- it's not being utilized. But I have a real concern on the copper area.

And, Mr. Burghardt, for you, people in your business, you're looking not only at that copper market as price discovery, but also to hedge, that you can -- when you're going to do a job and somebody comes in and wants to know how much copper they're going to have on a building, or the automobile industry says this is how much copper we need, you have to be able to hedge on that.

And I am concerned about all the extra anilities (?) out there, when I see there's a big strike in the largest copper mine in Mexico, and then I see the economy go down, and then why are the prices still up here, so if you could kind of talk a little bit about that concern of yours, and Mr. O'Hegarty, if you could respond, I'd appreciate that.

MR. BURGHARDT: Certainly, you know, for our industry, you know, copper is the critical, it's the raw material for our industry, and so we need a couple things. First we need markets for it, and for that to happen, it has to be cost effective. You know, we've already seen where we've lost markets, you know, because of the price of copper, because of substitution, so it needs to be price effective or cost effective.

What we see is, if you go back, copper was traded in a range of 70 cents to $1.70, and that was typically, you know, based on -- the cost was maybe 80 cents, 90 cents, you know, when copper was in the surplus, it went below, when it was in a shortage, it went well above, okay.

Not all that much has changed dramatically. But now what we see in our business is, copper goes in a range of $1.40 to $4.00 in a matter of a relatively short period of time.

So, number one, we don't feel that's reflective of fundamentals and cost. You know, fundamentals as far as demand haven't changed as far as consumption. If you look at warehouse stocks, you know, I pointed out earlier, the market is in a surplus, you know, why is the price doubling when the market is in a surplus?

So, clearly we feel that the market, which is so critical, you know, for our industry, because we use it to establish prices and to manage our risk, okay, but we feel it's gotten away from the fundamentals. We're still using it for price discovery, we still use it for risk, okay, we've applied for hedge exemptions in the past because we needed it to run our business, all right, but what we'd like to see is a reduction in speculation so that the price is now reflective of cost and fundamentals.

It's interesting, most of you heard -- I'm sure everyone heard of the large earthquake in Chile, you know, it occurred and it was a real, you know, catastrophe down there. I think the price moved seven cents that day. It moves less on an event of that magnitude than it does when one large player comes into the market, and we don't feel that's correct.

COMMISSIONER DUNN: Mr. O'Hegarty, if you'd response. Mr. LaSala, I'd like you to respond, as well.

MR. O'HEGARTY: Okay. I actually have given you some slides. These are 2009 figures, because they cover the whole year. Slide five is the capacity of listed brands. This isn't just total capacity, this is listed brands. And according to those figures, it's 14 and a half million tons is the capacity. And then you look at the stocks, slide seven gives you the stocks in LME warehouses during that period. And again, I'll just try to point out that the net figure compared to the gross figure in and out, this is not metal that people are taking and keeping as an investment, this is metal going in and out. Now, our market is run on the assumption that it is the delivery of last resort and the supply of last resort.

I think when Jeff was talking about his risk, he doesn't use markets to sort his metal, he needs it direct from the producer. If that pricing is against an exchange contract, and although the -- provides that, but a U.S. Price discovery, because of our three geographic regions, we provided global price discovery, and most of the trade outside the U.S., and even the trade into China, is basis the LME price.

So the volume you see trading on the LME is price risk trading, not metal trading, just in time, absolutely, but the three -- the most liquid contracts on our exchange is three month contract, it's a rolling three months, so every day you're trading for three months forward, that is price risk, it is not just in -- metal.

MR. LASALA: Mr. Dunn, to follow the comments of Mr. O'Hegarty --

CHAIRMAN GENSLER: Just trying to help, it's Commissioner Dunn.

MR. LASALA: Did I say -- I'm sorry. Commissioner Dunn, to follow Mr. O'Hegarty's, you know, comments, we'd agree that COMEX, in the copper, we've seen more movements in that in and out than the other metals. So it's been utilized by commercials to draw inventory more than others. It's been one contract also that we've made the most adjustments to in the context of the spot month limits.

Back in 2006, those -- the available metal was down in less than 100 contracts worth of material. We had a number of initiatives, making adjustments to the limits, margins and the like.

You know, further, to note Mr. Epstein's point about volatility in the market, in a International Copper Study Group, in 2009, found that there was a deficit of 140,000 metric tons in the first half of 2009, and then there's a half million dollar -- half million ton surplus in the second half.

And a point I'm simply raising here is that these dynamics, this is not one smooth playing surface, there are supply deficits, supply surpluses that the market is factoring in that will, in fact, lead to I think that volatility that's being noted. I don't see the investment, I think that may have been the genesis of your question, of -- in copper the same way as you do in more of the precious metals, gold and silver. Thank you.

CHAIRMAN GENSLER: Thank you, Commissioner Dunn. Commissioner Sommers. No, Commissioner Chilton.

COMMISSIONER CHILTON: I want to get briefly to exemption. And I appreciate Mr. Charles' response earlier. I will note, and I won't give a name, but representatives of other banks have told me that they actually could, not that it would be easy, but they could separate their own book from those of their customers, and therefore, they didn't have a problem with, at least one bank, they didn't have a problem with saying that they would use the exemption from any position limits for their own trading, for their own speculative trading.

That's sort of an important concept to me. I think it's maybe where we went awry on some other issues outside of our market. So I think, one, we should approve these exemptions. I'm not suggesting that the exchanges have done a poor job of it, but I think it's government responsibility, and I think we should do it, I think it's our job to step up to the plate. Two, I think they should be -- to the extent that we can craft one, make it targeted for legitimate business purposes and not for their own book, and I think it needs to be verifiable that we check on it all the time. And then finally, and this is in our energy proposal also, I think it should be transparent. I find it amazing that currently under our rules and regs, that we can't tell the public who has an exemption or even how many there are. So if we learned anything, it seems that, you know, the more transparency, the better.

Mr. O'Hegarty, I'm curious about the, you know, you've got a massive supply in London in metals, but are there multiple claims against some of those metals?

MR. O'HEGARTY: It's not in London, it's -- at the areas of net consumption, we try and have our locations -- consumption.

COMMISSIONER CHILTON: Okay.

MR. O'HEGARTY: The matter is always owned by one -- at any point in time, and so there's never any argument about, you know, who owns it. The concept of futures trading is that if I'm going to deliver tomorrow, I better have metal or I'll pay for it. If I'm trading up to five years, the metal is -- I'll worry about -- at the time, and therefore, you can't really tie up the futures contracts with the available supply of metal except that there is a continuum.

COMMISSIONER CHILTON: When you get to the spot month?

MR. O'HEGARTY: Well, basically you start out at five years being price discovery, trading price risk, and both consumers and producers do that. A day out is physically trading. Now, at what point in time it changes between the two is actually almost impossible to separate out.

COMMISSIONER CHILTON: I think on average, maybe Mr. Sherrod can give me a number here, but I think on average the futures to physical is ten times greater -- ten times greater, the futures. Do we happen to know what it is on silver or gold, off the top of your head? Anybody happen to know that off the top of your head? Okay.

MR. O'HEGARTY: Well, can I help you?

COMMISSIONER CHILTON: Yes, please.

MR. O'HEGARTY: The convention in the base metal markets is for producers and consumers to buy and sell basis a future price. So they will sell in a six month delivery basis what will then be the LME price. If they're both hedge, and they're both -- they'll agree to trade 100 tons, you get double the amount hedged on the exchange to put the hedge on, and then double the amount to take the hedge off again, so it's four times.

COMMISSIONER CHILTON: All right, thank you. And my time is -- I'll go real quick. Mr. Epstein, most of the large price moves that we see in silver and gold tends to take place when COMEX is open, yet, as Mr. Sherrod talked, there are plenty of other venues for trading of metals around the world, but COMEX seems to be where they have prices set; do you have a thought as to why that is?

MR. EPSTEIN: The futures markets in the United States are great. You've got the counterparty risk managed to be the clearing firms and the exchanges, you've got fair price discovery. The CME does a great job of providing a -- market right there all the time. There's no reason that price discovery wouldn't take place at COMEX. The fact that it has to have a reality check against physical trading as you get close to spot month, absolutely.

But in the gold and silver, particular more so than perhaps quite copper, I mean all of the trading takes place in spot months, and then on a single day it switches to the next month. And the trading that's taking place in July or -- right now doesn't take place in July -- it takes place in the May contract, because the roles are so clear and specific. So everything takes place in a single month in the precious metals.

COMMISSIONER CHILTON: Thank you.

CHAIRMAN GENSLER: Thank you, Commissioner Chilton. Commissioner O'Malia.

COMMISSIONER O'MALIA: Thank you. If I can congratulate Mr. Burghardt for his coming up with an alternative strategy. In your testimony, you raised the proposal that significantly higher margin requirements for investment funds would be a more effective solution. In light of the global nature of these markets, could we get everybody to comment on the impact that might have on trading, liquidity, and pricing? Maybe Mr. Burghardt might want to explain the proposal and then everybody comment on it.

MR. BURGHARDT: Sure; just to elaborate a little more, I think some of the discussions we've had already show that while we have had position limits, question how effective they've been. Also, it's my view that a lot of those position limits have really been to prevent spot squeezes in a commodity, and that's really not what we're talking about here, one or two players trying to squeeze, you know, the spot month in the commodity, more, it's a large group of speculators coming into the market, not necessarily in spot positions. And the concern is, if we put position limits on, that more and more speculators could continue to come into the market and become a higher percentage of the market overall, okay. As long as they don't hit those position limits, you know, the speculation, the percent could increase overall in the market, and that's why the alternative.

Many of the markets have margins of, you know, five to seven percent, which I feel is very low and certainly invites a lot of volume as people come in with dollars, they can trade a large number of contracts, so that's the reason behind it.

COMMISSIONER O'MALIA: So your proposal is to raise the margin?

MR. BURGHARDT: Correct.

COMMISSIONER O'MALIA: And then maybe we can get everybody to comment on that.

MR. EPSTEIN: I thought it was kind of interesting when you said it. But the reality is that, you know, the large players aren't capital constrained, you know. If there's a five or seven percent margin or ten or 15 percent margin, you know, I mean right now the margin in silver is, I guess, you know, about seven -- eight percent, you know. If I had to post 100 percent margin, I'd still do all the same trading. So it's not -- and for the big people that are taking positions, you know, large financial institutions and so forth, you know, they can't take the risk of controlling, you know, an asset without having the reality that they can have a margin call the next morning.

So I don't think raising the position -- raising the margin is going to substantially effect any of the trading. Reducing the size of the position limits, if that brought in a more robust marketplace through more participation, I think you'd wind up with fair price discovery through that mechanism.

MR. CHARLES: I think my only comment would be that, as I made clear in my statement, that the markets are very, very global, there's a lot of markets around the world, the U.S. is just one market of many. If you disadvantage participants in the markets in the U.S. alone, then the potential is that customers will just take their business elsewhere.

MR. LASALA: Commissioner O'Malia, I'd have to respectfully not support Mr. Burghardt's recommendation. That being, our methodology in the futures industry for setting margins has been in response to volatility, price movements. It sounds here like we're going to use somehow margins to, in effect, control it. It, to me, is the, you know, the opposite of what we're trying to achieve. Margins are in response to when we raise, when volatility increases, we raise margins as appropriately needed. Thank you.

MR. O'HEGARTY: Interesting; I think the point has been made so far that margin is a credit risk management tool, and therefore, once you start using a tool for different reasons, you start introducing unintended consequences, and there are various issues in that.

Trading is still all about buying and selling it for more than you bought it for, and therefore, if you increase the cost of purchase, well, then somebody still has to sell it for more. Buying is driven by those who think they can sell it for more.

And so I think it introduces -- whether it changes the fundamentals or perception of supply and demand, I'm not so sure. And the same way I think ultimately position limits and what we -- our lending guidance are effective tools for settlement squeezes. Whether they're effective tools for managing a price, and this is a big debate around the world, and -- had a conference

-- regularly has conferences discussing the role of markets as price discovery and creating proper price discovery for producers, farmers and the rest, but whether you can manage the price I think is always drifting into it, and I think that's where part of the difficulty is.

If you can point to a mechanism in the exchange that it's failing, is there market failure, that's a useful way of working on what's going on. If what you're just saying is, you don't like high prices, that's tricky, because for the fabricators, copper prices at the moment might be a nuisance, but up until 2002, it was a real problem for the producers, and there was massive under investment in copper production for that same reason.

It's a two-sided market. High prices are good news for one person who produces it and bad news for buyers, and vice versa.

CHAIRMAN GENSLER: Commissioner O'Malia, I thank you. I think Commissioner Dunn has a couple more questions, I don't know if anybody else does. I just wanted to also mention something that -- I hear you all talk about price discovery markets, which I think is fabulous, and I guess I can't lose an opportunity to say that's what at least this Commissioner wants to bring to the over-the- counter derivatives marketplace. When I hear Mr. Epstein talk about bringing market makers in and having real time, even electronic feeds to a market to see, even if it's co- located, I think that that would be an advancement in these right now opaque derivatives markets, but I'm going to turn to Commissioner Dunn to ask his follow-up question.

COMMISSIONER DUNN: Well, let me associate myself with your comments on over-the-counter, not Mr. Dunn. And I whole heartedly agree with the Chairman on that, and I think it's extremely important that there not be a cut-out exemption by Congress for end users, that I would prefer that Congress give us the latitude of providing exemptions for those we think deserve an exemption on those end users.

That said, let me -- Mr. LaSala, if you couldn't tell from the tone of my questions with the DMO, I think that we're just entirely too loosey goosey on accountability level, and loosey goosey is the regulatory term that we use here. But would you -- first of all, how do you go about setting accountability levels? What type of impact does, or input does the industry have in setting those levels? And would you be opposed to the codification of working with DMO when someone exceeds accountability levels so that we at the Commission know that somebody is taking a look at it and there is positive action being taken when somebody steps over those accountability levels?

MR. O'HEGARTY: If you can think about this for a second while he responds, and I'm intrigued with the lending guidance that you develop. In I guess '98, '99, you put together a paper, The Way Forward, and I'd like to understand the industry involvement in that and how you came up with those lending guidelines. So Mr. LaSala.

MR. LASALA: Commissioner Dunn, insofar

as the accountability levels, I think I may have mentioned earlier that, you know, the key focus, as they are not in the front month and they're more distant months, has really been one of concentration.

In regard to your question about have we worked with industry, not particularly solicited, you know, their exacting thoughts about it, but I think by virtue of the fact that we have reached out to players over time and to the effect of asking them not to increase when they hit a certain percentage or to decrease, I think that the trading community has got a pretty good idea of where those sensitivity points are. We do not make them, you know, we do not state them formally, and every market situation is different. I believe that the ability to have them flexible, quite frankly, is advantageous, and I'll just give you an example. As you start making them more rigid, they start more and more resembling limits that I, you know, just, quite frankly, think will lead to, for some entities -- some entities will look at it as a nuisance and look for alternatives, some of them will just look at it as a barrier to conducting business.

In more tight markets, you might look at a percentage of X that someone obtains and you're more sensitive to it; under different market conditions, it might be, you know, a little bit more than X. Flexibility is important. And I think we've done an admirable job of monitoring these markets and not allowing excessive concentrations to adversely effect them.

That stated, to your point of would it be open to, you know, having discussions with DMO, we'd certainly be open to having that kind of a discussion. We've certainly, whether it be in the metals contracts or in the energies contracts, had discussions with DMO in particular market circumstances, to have a more global one to talk about our ideas about where those sensitive points are, I'd certainly be willing to have that discussion, but I say that with the caveat that I still ultimately would value having the discretion at the exchange level because I think we are just, quite frankly, closest to these markets, and that by no means is a shot at the division market oversight in any way, shape or form.

COMMISSIONER DUNN: Your answer then was on should we codify what we do at the point in time when someone exceeds accountability levels and that you think it would be all right, but you don't necessarily think it's a good idea?

MR. LASALA: I would say that I'm not sure if it's a good idea, that's right.

COMMISSIONER DUNN: Mr. O'Hegarty.

MR. O'HEGARTY: Commissioner, thank you. Yes, the lending guidance came after what was no secret at the time in '96, a settlement squeeze on the exchange, that was -- had gone on for a while and was very dangerous. Two things came out of that, one was the exchange realized that it needed much better visibility on control of LME warrants. They are the currency for settling LME contracts. And so one of the things covered in the way forward was the available information to the exchange. So today electronics have helped. We get electronic reports -- by 9:00 have a total picture of the market as of close of business yesterday. And the second point is, once you have the information, what do you do with it? And the lending guidance was built on the previous tool we had, which was a backwardation limit, in other words, imposing a limit to the price for trading tom/next is in effect, how you deal with the settlement squeeze.

And it's -- the consultation that went on was, should there be position limits, should there be fixed backwardation limits that apply to the whole market, should they be on a percentage basis, should they be a fixed amount basis.

And there are pluses and minuses in all of those areas. One issue about position limits, fixed ones, is that the available supply fluctuates depending on the cycle in the market. Similarly, the amount of money you talk about as a percentage of the cash price fluctuates. And so what we've ended up with was the lending guidance, which is a more refined tool now than it was when it first came in '98, and that's why I submitted a notice we did in 2005 that talks you through how it works, because the principle is straight forward. Somebody with a dominant position has to lend into the market, in other words, sell tom/next at pre-determined rates. Like most things, the details get complicated for those who actually do it day by day, and that's what the document goes into.

We, in effect, treat 90 percent as total control of our market, and therefore, anyone who has a 90 percent, on our calculation, it's not 90 percent of the warrants, it's 90 percent of the warrants and entitlement to pick them up in the next two days. In other words, your net long position is over a three day period, in effect. So that's why it's possible to have a dominant position of well over 100 percent.

Anything over 90 is treated as control, and therefore, you have to lend at level, you just have to give it away for a day. In practice, what we've discovered is that the 50 to 80 percent bracket rarely has much effect on the market. Eighty to 90 starts showing, in effect, and this is why the backwardation is tightened on that by us. And 90 we treat as an effect of control.

Is the advantage of it as a tool is open and a legitimate expectation on both sides of the market. The shorts and the longs know how it works. And in the last ten years of its operation, we have found that the role of concentration of positions in warrants and the settlement has stopped being the tail wagging the dog in our market. What drives our market is the three month price. That's three months forward. Again, you know, it takes a while to get your head around it, but it's a rolling three months, so there's no backwardation or -- in that price.

Today it's three months, tomorrow it'll be three months from tomorrow, and, therefore, it is a pure commodity related price. The cash to three backwardation -- it's all contained in the moment is, what happens if you've left it a bit late. Three months is a reasonable amount of time in the metals industry to plan, less than three months is, you're now just in time.

And therefore, we have -- there are two measures going on. What's the three month price telling you? In other words, what's the perception of the commodity value? What's the cash in three prize telling you, is there a shortage of supply?

CHAIRMAN GENSLER: Thank you, Commissioner Dunn. Is it on this point -- all right. Mr. Burghardt.

MR. BURGHARDT: To just share one point, you know, he mentioned, you know, that currently everything isn't contained, well, you know, contangle markets occur generally when you have a surplus, you know, which is another indication, why we feel that the prices right now aren't reflecting fundamentals.

CHAIRMAN GENSLER: Thank you. I want to thank our first panel. It's been very helpful to the Commission and in our deliberations. I called the Commissioners just a short while ago and I just want to make sure, if we didn't take a ten minute break, whether -- all right. So if we can invite our next panel up if they're here. Again, I want to thank our panelists, and it'll probably take two or three minutes just to do so. I just want to say, for those who actually do leave the room, apparently you'll have to go back through the security that's out there again, so I just -- I want to be, you know, be aware of that.

(Recess)

CHAIRMAN GENSLER: If I could ask the members of the public to find some seats. And I don't know if we have all five of our panelists, but we have three, we can start there. And I want to thank our panelists and -- here, I'll go from right to left in this circumstance just because we don't have all the seats filled here. But we have Tom Callahan, it's good to see you, Tom, who is head of U.S. Futures Business at NYSE Liffe, and responsible for the futures trading activity, and has been at -- I guess you've been at Euronext, New York Stock Exchange, Euronext, for about 15 years, if I have this right; is that right?

MR. CALLAHAN: Two years.

CHAIRMAN GENSLER: Two, well, then my notes -- oh, no, I'm misreading, after 15 years at Merrill Lynch, all right, but it just feels that way.

MR. CALLAHAN: It just feels that way.

CHAIRMAN GENSLER: All right. And Kevin Norrish, who's head of Commodities Research at Barclay's Capital, he's a Managing Director in the Commodities Research Team at Barclay's, and he's been really a leader in research in various ways before that. And, Kevin, I noticed also that your documents include a lot of use of CFTC data, so I guess, you know, somehow our transparency initiatives have been used by somebody, and so we thank you for that.

Doctor Jarecki, it's so good to see you back. You last testified here last summer, I remember some very helpful dialogue and exchange at that point in time. And Doctor Jarecki, who's

Chairman of Gresham Investment Management, but has been a real leader in a number of fields, not only the fields that we're talking about here, but the fields of psychiatric treatment, a leading expert there, but more relevant -- is it right that you were the founder, maybe along with others, with the Mocatta Group years ago and was really the largest gold and silver trading company, and so his association with these issues goes back decades.

DOCTOR JARECKI: (off mic)

CHAIRMAN GENSLER: Okay. Well, now I didn't mean -- I thank you for that clarification, very good. I can see this is going to be a lively afternoon. And good to see you also, John -- I did it wrong the last time, so you're going to help us, Lothian, John Lothian, who's Chief Executive Officer of John J. Lothian and Company. But this online education and media company publishes newsletters, blogs, now wikis and so forth, and he follows these markets closely.

And then our last panelist, Bill Murphy, who is with the Gold Anti-Trust Action Committee, and he chairs the GATA Summit in South Africa, and he's been involved in many of these issues. So we thank all of our panelists, and we're going to go I guess from right to left. And if you have written statements, they'll be included and they'll be on our web site, but if you could try to help us summarize in four or five minutes, that would be terrific.

MR. CALLAHAN: Absolutely; Chairman Gensler and members of the Commission, my name is Tom Callahan, I'm the CEO of NYSE Liffe U.S., the U.S. Futures Exchange of NYSE Euronext, and it's a great honor to appear before you today.

Launched in September, 2008, NYSE Liffe U.S. is registered with the CFDC as a designated contract market. It currently clears its contracts through the options clearing -- The National Futures Association conducts day- to-day market surveillance of our exchange.

Our parent company is NYSE Euronext, a leading global operator of financial markets and one of the world's most highly regulated global financial firms. NYSE Liffe U.S. provides fully electronic liquid market for physically deliverable gold and silver futures, options on gold and silver futures, and many size gold and silver futures, as well.

The lineage of our exchange traces back to what was once known as CBOT Metals, which was divested by CME Group in March, 2008, so as to observe competition in the U.S. metals market in the face of the pending CME merger with NYMEX, COMEX. NYSE Euronext is working hard to deliver on this objective to promote fair and effective competition. In the U.S., we directly compete with CME's COMEX exchange. Currently, our young exchange is trading roughly five percent of the total U.S. precious metals futures market by volume. In our attempts to establish a world class U.S. futures exchange, we are investing heavily in our platform and recently took on six important market participants as partners in this endeavor.

Today I'd like to address certain areas of focus for the Commission as you review regulation of the metals futures markets. We share the Commission's objective to ensure that the U.S. precious metals markets remain fair and competitive for obtaining the highest degree of integrity, the protection of investors.

In its capacity as a CFTC registered DCM NSRO, NYSE Liffe U.S. currently places position limits on its metals futures products. Our current levels of position limits are extremely conservative and we believe protect the market from manipulation and excessive speculation. These limits are set by the exchange. NYSE Liffe U.S. has maintained these conservative limits because it retains the flexibility to adjust them as market conditions may demand. One of the clear lessons from the financial crisis is that the exchange traded and centrally cleared market model performed exceptionally well as the over-the-counter markets faltered. Accordingly, as new regulations such as position limits are contemplated, the CFTC should be mindful that they are implemented in a way that does not force business away from regulation exchanges and into the over-the-counter markets or to foreign jurisdictions.

In addition, the federal position limits are determined to be necessary for the metals markets. The CFTC should design the regime so not to solidify competitive advantages for the currently dominant exchanges or to hinder the migration of OTC business to a centrally cleared exchange traded environment.

Someone suggested that the CFTC take into consideration the relative size of a market when administering certain position limits. For start of exchanges like NYSE Liffe U.S., it would be difficult, if not impossible, to gain market share against an existing exchange if position limits were administered in a manner that capped growth or growth potential.

Should federal position limits be needed, either limited exemptions for new competitors or minimum position limits should be in place to ensure that competition is not hindered by cross market position limit regimes that would lock in market share with an incumbent exchange. Finally, while I speak today as the head of our U.S. futures trading business, NYSE Euronext also has a significant exchange traded products business that will be impacted by position limit policies.

An exchange traded product is an investment vehicle traded on a regulated security exchange which typically owns assets such as stocks or bonds, though more recently are diversifying into other assets like commodities. They provide retail investors with a cost effective way to invest in and hedge commodity exposures through regulated transparent marketplaces.

Recent months have seen certain energy ETF's for commodities either close up or move overseas in advance of anticipated position limits. While rational position limits as we impose on our exchange today are needed to protect against manipulation and excessive concentration, the Commission should be mindful that federally set position limits could have a serious negative impact on other markets that use futures contracts to either discovery prices or manage risks. As new entered into these markets, NYSE Liffe U.S. is committed to the derivatives marketplace and eager to compete for the benefit of investors and consumers. Thank you for allowing me to testify.

CHAIRMAN GENSLER: Thank you, Mr. Callahan. Mr. Norrish.

MR. NORRISH: Good morning, ladies and gentlemen. My name is Kevin Norrish, I'm a Managing Director in the Commodities Research Team at Barclay's Capital. I think the CFTC is to be commended for holding this debate and I'm very pleased to be here to make a contribution to it.

My background is that I've spent 22 years analyzing and researching industrial metals markets, and I've seen a number of big changes in the markets in that time. Two of the most important I think are the real growth in the use of futures markets by producers and consumers to manage their very real day-to-day price risks.

The other evolution that I've seen which I think is also very important, and particularly in the last ten years, is the increasing use of the commodities futures markets by financial market participants who are seeking commodity risk in order to protect against their own inflation risks or to diversify their portfolios. Now, I think those two developments are very mutually beneficial. What I want to do over the next few minutes or so is to really focus on three key issues which I think are really very important to this debate. I think the first point that I would make is that I think financial involvement in the commodities futures markets is a very good thing and we need more of it.

And the reason for that I think is that we face over the next ten to 15 years a massive increase in demand for commodities, all sorts of different kinds of commodities, and that's being driven by what's going on in the industrializing Asian nations, the rapid growth in industrialization, living standards and urbanization, which is driving huge additional demand for commodities, and that's going to continue for a long time.

I've got one of my slides up on the screen here at the moment, and that shows you that the International Energy Agency believes that $25 trillion needs to be spent over the next 20 years, just in energy supply infrastructure, not in other commodities, but just in energy supply infrastructure.

Now, how is that demand going to be met? Well, this demand is coming at a time when it's very clear there are a number of supply constraints in many important commodities markets. That's partly due to a lack of deposits, a lack of expiration development activity, supplied bottlenecks, and a lack of qualified labor. So it's really very important I think that we have large liquid financial markets to assist producers in being able to make these very big investments and to be able to protect the risks that they have.

I remember very well the 1990's, when there was very little financial market involvement in the commodities markets. And back then, markets were depressed, and what we saw, the behavior from producers then was that producers would cut costs, there was very little liquidity for them to manage their risks, they would cut costs, and they cut back on exploration and development.

That's part of the reason why we have high metals prices today. So I think it's very important that we have the financial market participation. I think there are two key things; first of all, there's a huge mismatch between producer's needs to manage their risks, very large capital intensive projects, often of very long time periods that they need to manage, and consumers who tend to be a lot smaller and have much shorter time periods to manage their risk over, so the financial market participation helps to bridge that gap. I think I would say the other thing is that we need large financial institutions involved in these markets, as well, and that's because commodity market risk by its very nature tends to be lumpy and unpredictable. You know, we have large capital intensive projects to risk manage, large amounts of inventory to finance, and these things can only really be done by flexible large financial institutions that are able to lay off that risk in different ways, in the futures markets, in the over-the- counter markets, and in the physical markets.

So I think we need more of this kind of activity. This kind of activity needs to be encouraged to grow. We don't need less of it. So that's my first point.

My second point is that when it comes to the role of U.S. futures markets, commodity futures markets, and particularly the metals markets, that crucial role of price discovery and liquidity is very easily exportable, and I'll tell you why, it's because we've seen a huge shift in the nature of commodity market demand over the last few years.

Let's go back to 2002. Back then, the U.S. Consumed as much copper as China did. Today, China consumes three times as much copper as the U.S. does, and that number is just going to continue getting bigger. So I would say that given those sorts of changes, the U.S. Commodity futures markets, and particularly the metals markets are punching above their weight. They are continuing to play a very important role in global price discovery and in the addition of liquidity to markets, enabling people to use them to manage their risks.

I think the danger is that if unnecessary position limits are imposed in U.S. markets, then it will drive that liquidity to other venues, and you will see a reduction in the relevance and importance of U.S. markets.

And my final point is on the role of index investors specifically. There have been a lot of wild things said about the impact of index investors on prices, and I think, you know, I would like to just correct the record a little bit.

When we look at the role of index investors, my belief is that they act as price stabilizers, and that's because index investors are seeking commodity price exposure in order to diversify their portfolios, so they tend to buy when prices are low and sell when prices are high, and you can see that in my chart here in the oil market.

So just to finish, I would say that U.S. markets need to continue to be a very important part of these global financial markets. We need to encourage speculation.

CHAIRMAN GENSLER: If I could ask you to --

MR. NORRISH: Yeah, I'm just making my final comments. Sorry, I've gone a little bit over my time. But I think we need to encourage financial market involvement. We need to consider flexible accountability limits are the way to go, because commodity markets do need the flexibility. It's that flexibility which best serves all market participants, the producers, the consumers and the financial institutions.

CHAIRMAN GENSLER: Excuse me, thank you.

MR. NORRISH: Thanks very much.

CHAIRMAN GENSLER: Doctor Jarecki.

DOCTOR JARECKI: Good morning. My name is Henry Jarecki, I'm Chairman of Gresham Investment Management that provides advice and execution services to investors, large and small, who wish to diversify stock and bond portfolios by -- am I on the end? Now I'm good. I apologize. I hope you don't count this time against me. My name is Henry Jarecki --

CHAIRMAN GENSLER: No, it started over.

DOCTOR JARECKI: -- that provides advice and execution services to investors, large and small, who want to diversify their stock and bond portfolios by adding a diversified pool of commodities to them. And I thank the Commission for inviting me to appear before it again, and I presume you have all brushed up on your Latin in preparation for my testimony.

It is worth emphasizing first off that the futures markets have over the past two years proven themselves to be immune from the troubles and especially the risks and balance sheet fiddles that afflicted the over leverage stock, bond and real estate markets.

I think this is because they deal with leverage in a rational way. Namely day in and day out, they mark all customers, big or little, commercial or speculator to market and they get good initial margins, safe initial margins to start this.

Now, I know quite a bit about this. The bulk of my experience in trading commodities was gained when I was the Chief Executive of the Mocatta Group, which was for 300 years the largest precious metals dealer in the world. And in that capacity, and as a member of the COMEX Board, I witnessed firsthand the Hunt Brothers attempt to corner the physical silver market. They moved the price up by buying physical supplies, and as they bought more and more, banks and brokers granted them more and more credit on their physical holding, and everybody started to worry that the bubble would burst, the Hunt's would fail, and they would take the banks and brokers down.

The Treasury Department, the Federal Reserve asked the then Chairman James Stone to intervene in the markets, but he said that the markets had the ability to regulate themselves and the best thing to do was nothing at all.

Perhaps he had heard of the ancient Greek who said (Greek) which is to say it takes great courage in a time of crisis to do nothing. Over the next few months, the price rose from $7 all the way to $50, and the American public took its rings off, sold its silverware, and even took out its silver fillings and sold them. Billions of dollars worth of new silver was refined and came on the market. The Hunt's tried to buy it to prevent the price drop they thought would bankrupt them, but the little guy had more silver than they had money and the corner failed. I'm going to comment more on metals in my written submission, but I wanted to mention the importance in thinking about position limits of disaggregating the positions of firms like ourselves who constantly tell our customers and the world at large just what mix of commodities is going to best lower the risks of stock and bond portfolios.

We buy that mix for a customer only when that customer instructs us to do so and deposits with us all of the money that all those commodities would ultimately cost. His investment is thus fully funded, not partially margined, but fully margined with fully funded money.

We don't trade for ourselves, we don't use leverage, we don't hold positions in spot months, we don't do it for our customers, and with that, all that, it's impossible to conceive excessive speculation or a squeeze. That's why we think of ourselves as passive mechanics of our customer's riches, and we think it's irrational and anti-competitive to aggregate our dozens of customer's fully funded positions as if they were our positions.

And I was happy to see that this passive mechanic concept was taken up by Chairman Gensler at the recent energy hearings, when he said that he didn't "see a Goldman Sachs or JP Morgan swap desk as a passive mechanic." It's a highly sophisticated risk business, not a passive mechanic. Still, those enterprises can take as large a position as they want to hedge their exposures. And it's astonishing to us that a firm as small as we are may be forced off the safety of the futures markets and onto over- the-counter markets while our big competitors stay on.

Hereto, it was Salon the Apennine who said, laws are like cob webs, if any smaller creature falls into them, they hold it fast while something weightier can break through the web and run off.

To sum up, I would make full recommendation to the Commission, number one, position limits on metal futures can force such business into alternative channels such as over-the-counter, overseas markets, or most important, into physical storage, because our kinds of customers have all the money they need to fully buy the metals and we'll do so.

Secondly, the CFTC should continue to collect trade data so it has a complete picture not only of who is implementing trades, but who is benefiting from them. Third, once you identify that an entity is merely the implementer and not the beneficiary of a fully funded, transparent, on exchange strategy, that entity's activities should be attributed to the ultimate beneficiary. Finally, don't tell yourselves that it's hard to identify the end users, it is administratively trivial to do so. You do most of it already by the large trader reports, and these would only need to be modified slightly to collect the data necessary to identify all those who control large and possibly dangerous positions. And I thank you for allowing me to offer my remarks on this important subject, and I commend the Commission for its efforts.

CHAIRMAN GENSLER: I thank you, Doctor Jarecki. It's a great honor to be quoted along with the Greeks and the others, so I don't know. Mr. Lothian.

MR. LOTHIAN: Thank you. I'm the President and CEO of John J. Lothian and Company, a market focused new media firm and commodity trading advisor. I am also a futures broker and President of the Electronic Trading Division of the Price Futures Group, Incorporated, a Chicago based introducing broker. I am here representing my own views. Thank you for inviting me.

I want to talk about gold. Gold is the most international of commodities. No one nation has a compelling right to monopolize or dominate the price discovery process. More and more futures exchanges around the world are introducing precious metals trading, catering to their local market participants, and impacting the global price discovery chain. Gold has little industrial value, rather, it is -- it's value is based largely on a system of belief of its value as a store of wealth and is a replacement for paper money.

No longer do nations back their currency in gold. However, history is replete with examples where gold has served as a risk management tool for times when nation's ability to repay its debt has been in doubt. In times of war, when the debt of a nation could be worthless depending on the outcome of the war, people have flocked to gold to hedge this default risk. Consider gold historically as the ultimate credit default swap.

I believe gold emerged from the commodity bull markets of recent years in the financial crisis of 2008 as the commodity to own because there was no natural political constituency calling for lower gold prices. Gold became the commodity of choice in which to invest, not only because of its unique political dynamics, but also because of the dramatic rise in public debt used to offset the impact of the financial crisis of 2008. Rising concerns about government's ability to repay the public debt through taxation renewed gold's value as a global CDS. The rush to invest in gold, gold derivatives like futures or securities like ETF's only fueled more demand as prices took off and breached historic levels.

Also, low interest rates reduced the costs associated with holding physical gold and other metals contributing to higher prices. The rise in political populism in the U.S. also plays a role in gold in our society, in individual and hedge fund portfolios, and brings to the surface historical pressures between creditors and debtors.

There are those who openly espouse the view that gold and silver prices should be dramatically higher, but gold and silver prices are manipulated by central bankers and others to somehow keep inflationary expectations low. This narrow view of the nature of inflationary expectations is intellectually dishonest.

Back in the late 1970's, when gold and silver had historic price moves and met higher levels of inflation, we did not have as many risk management tools to hedge inflation risk as we do today. Back in the 1970's, some traders and investors used things like soy beans, pork bellies, and gold and silver as a proxy to hedge against inflation. Bond futures were still in their infancy, and -- futures had yet to be invented. Today we have liquid futures markets around the world for investors, governments, corporations, individuals to hedge their specific inflation risks.

Those who believe gold and silver markets are manipulated to keep prices low are nothing more than politically opportunistic rent seekers in my book. They are parasites on the body public profiting from selling fear and seeking political change that will benefit their world view and related market position by selling views which undermine the trust in the listed metals futures markets, metal ETF securities, and even physical gold holdings of the U.S. government.

These charlatans foster a view that distorts the metals markets and impacts efficiency. Healthy skepticism is right and proper, dogmatic mistrust is merely pseudo skeptical behavior which cherry picks evidence to "support pre-existing beliefs."

In precious metals markets like gold, the category of financial hedger should be interpreted very broadly. While there are bona fide hedgers who mine and produce gold or consume it for electronics or jewelry, this activity dwarfs the trade in those using gold positions or holdings to hedge against political or financial uncertainty. Even the physical metals holdings of the central banks themselves could be considered a financial and political hedge.

For those who see gold as a substitution for holding other assets, including U.S. dollars, any action which restricts their ability to move into and out of physical metals futures or ETF's will be viewed negatively. These actions will not produce the intended results or intended effects.

Position limits on financial hedgers in the U.S. Will merely move global interest in the markets through other markets outside the U.S. Position limits on gold should be liberally interpreted and exclude financial hedgers, however, there should be greater transparency for concentrated holdings of metals whether public funds or private investments. Accountability reporting should be expanded as positions grow larger. Think of harmonization between securities and futures.

Lastly, position limits have their place in our markets, particularly in the futures and cash convergent process. However, I ask the Commission to act carefully in regard to proposal speculative position limits in metals before Congress acts on the issue of OTC trading in general. I believe acting hastily could put futures markets at a competitive disadvantage to the OTC markets and non-U.S. futures markets. Thank you.

CHAIRMAN GENSLER: Thank you very much. Mr. Murphy.

MR. MURPHY: I'm going to have to make like the roadrunner here so bear with me as I read this. Dear Chairman Gensler, Commissioners, the Gold Anti-Trust Action Committee was formed in January, 1990 to expose and oppose the manipulation and suppression of the price of gold. What we have learned over the past 11 years is of great importance in regard to this hearing on position limits. Our efforts to expose manipulation to gold market parallel roles of Harry Markopolos to expose the Madoff Pozi scheme to the SEC.

Initially we thought the manipulation of the gold market was undertaken as a coordinated profit scheme by certain bullion banks like JP Morgan, Chase Bank and Goldman Sachs and it violated federal and state anti-trust laws. But we soon -- bullion banks were working closely with

U.S. Treasury Department and Federal Reserve and a gold cartel, part of a broad scheme of manipulation of the currency, precious metals and bond markets. As an executive at Goldman Sachs in London, Robert Rubin developed an idea to borrow gold from central banks at minimal interest rates, around one percent, sell the bullion for cash and use that cash to fund Goldman Sachs operation. Rubin was confident central banks would control the gold price -- leasing of outright sales of their gold reserves, and then consequently that borrowed gold could be bought back without difficulty. This was the beginning of the gold carry trade.

When Rubin became U.S. Secretary, he made a government policy to surreptitiously operate an identical gold carry trade, but on a much larger scale. This became the principle mechanism of what was called the strong dollar policy.

Subsequent Treasury secretaries repeated a commitment to a strong dollar, suggesting they were continuing to feed official gold into the market, more or less coinvescently to support the dollar and suppress interest rates and precious metals prices.

Lawrence Summers, who followed Rubin as Treasury Secretary, was an expert in Gold's influence on financial markets. Previously, as a Professor at Harvard University, Summers co-authored an academic study titled Gibson's Paradox in the Gold Standards, which concluded that in a free market, gold prices move inversely -- interest rates, and conversely, if gold prices are fixed, then interest rates can be maintained at lower levels -- free market.

Then chairman, Alan Greenspan, said Summers -- when he remarked that a 1993 meeting at the Federal Market Committee, "I was raising the question on the side with Governor Mullins and what would happen if the Treasury sold a little gold in the market." That's an interesting question here because if the gold price broke in that context, the thermometer would not just be a measuring tool, it would basically effect the underlying psychology.

President Obama has called for a greater transparency in both the federal government and financial markets. In pursuit of such transparency, God has made Freedom of Information Act request to the Fed and Treasury Department for a candid accounting of their involvement in the gold market.

In a reply to GATA -- dated September 17, 2009, Fed Governor Kevin Marks acknowledged that the Fed is gold, so -- with foreign banks, but insistent that such documents remain secret. As a result, last December, GATA sued the federal reserve in U.S. District Court -- feds with held record of gold swaps. Understanding the manipulation that price is gold is profoundly important to all markets in the American public, on January 31, 2008, GATA places a $264,000 ad in the Wall Street Journal. GATA -- this manipulation has been a primary cause of the catastrophic excesses in the market, but now threaten the whole world. What GATA warned against has come to pass.

GATA has long implicated the COMEX as being a mechanism by which gold and silver price suppression is implemented. The smoking gun is the excessive concentration of bullion bank positions whose concentration enables market manipulation just as market manipulation was a justification by the CFTC in 1980, when it acts against the Hunt Brothers for manipulating the silver market.

The weekly commitment trader report documents the total net short position of commercial traders in the commodities market. The monthly bank participation reports disclose the U.S. banks at various markets. In a letter to GATA dated February 19, 2010, Warren Gata, a CFTC legal assistant wrote, "the Commission determined whether a number of banks in each reporting category is particular small, fewer than four banks. There exists the potential to extrapolate both the identity of individual banks and the bank's position." As a result, as of December, 2009, the CFTC no longer discloses the number of banks when it's less than four. The CFTC has been investigating possible manipulation of the silver market for more than a year, so this report change is disturbing.

The CFTC's own reports of November, 2009, show that just two banks held 43 percent of the commercial in that short position in gold and 68 percent of the commercial in that short position in silver. In gold, these two banks were short 123,000 contracts, but long, only 523 contracts. And in silver, they were short 41,000 contracts, and long only 1,400 contracts. How improbable is it that these two banks attract most of the investors who want to sell short.

It has been possible to extrapolate the two banks that hold these large manipulative short position to COMEX or JP Morgan, Chase and HSBC, because of their positions in the OTC derivatives market, whose regulator, the U.S. Office of the Control of the Currency does not provide anonymity when it publishes market data. In the first quarter of 2009, OTC derivatives report, JP Morgan, Chase and HSBC held more than 95 percent of the gold and precious metals derivatives of all U.S. banks with a combined -- value of 120 billion. This concentration dwarfs the concentration in the gold and silver futures market and -- great concern about the position of an issue.

GATA has evidence there are huge physical short positions in the gold market that cannot be covered -- stress caused by -- physical demand is threatening to lead to a price explosion which restore the markets, the balance that regulation has failed to maintain. In our view, the COMEX -- becomes dysfunctional --

CHAIRMAN GENSLER: If you can just try to sum -- finish up.

MR. MURPHY: We're finishing up -- with -- having to be declared in the -- unable to -- on the obligations. We urge the CFTC to report fully and candidly on these markets and take appropriate action. Thank you.

CHAIRMAN GENSLER: Thank you. I want to thank all of our panelists. I'll just start with a question I sort of asked the earlier panel, too, but I don't know whether Mr. Norrish or anybody could have from their research. Just one of the issues, it's maybe a little bit more in the silver market and these other precious metals markets is the concentration of these markets is more than the concentration let's say in the energy markets that we explored last year, and just to help us understand that concentration and how that effects the fair and orderly markets, because I agree with an earlier panelist that this Commission is not a Commission to set prices, it's not a price agency in any way, it's -- our main mission is to make sure that these price discovery markets are free of fraud and manipulation and that they're open and fair.

But I'm curious what you think about the large concentrations and how they effect that price discovery marketplace. So I'm just starting with Mr. Norrish, but others can comment.

MR. NORRISH: I mean I think, you know, as the remarks I was making in my introductory comments I think were relevant to this, it's very important I think that there is the ability within all commodities markets and within metals markets, as well, for financial participants to be able to be flexible in their approach and take large positions when they need to, because the very nature of commodity market risk does tend to be quite lumpy. As I said, you've got large physical position --

CHAIRMAN GENSLER: Not to repeat what you've already said, my question is, though, when you get highly concentrated positions, whether the price discovery function is aided or whether, in fact, it might, you know, you might get sort of a tipping point, whether it's a balancing that you get, sort of maybe even less liquidity, because there's this, you know, I think Mr. Epstein used the term, I'm not sure, was it a big gorilla or something, but there was some term, but, you know, that you have that in this situation. You want to hit your --

MR. NORRISH: My experience is much more of the industrial metals markets. And I --

CHAIRMAN GENSLER: So maybe other panelists. I mean I saw Doctor Jarecki was -- no. Mr. Lothian.

MR. LOTHIAN: The natural being of things is for consolidation. We see that in the brokerage firms, we see that in the banks, we see that in the exchanges. And so there is a natural progression towards that, and it does approach a tipping point where it becomes an issue, and that's your challenge to be courageous or not depending on how you want to do something.

That being said, it's present in all of our society, it's, you know, it's not any different there. I think the greater transparency in large concentrated positions can help offset some of that. We have lost a degree of transparency in the metals markets as things have moved from open outcry in electronic to electronic trading, who the participants are and what they're doing, so it's harder to track. And so in my comment about harmonization, for example, if I take a five percent interest in a company, I have to disclose that, okay.

So if we're getting into higher levels of participation, perhaps the CFTC rules should be changed and those things should be disclosed.

CHAIRMAN GENSLER: Let me -- I see my light flashing. If I could ask maybe Doctor Jarecki, because you ran such a large precious metals company for -- and I apologize, I didn't mean that you were there in 1671, I confused it with some of your ancestors maybe. But you were maybe here when the gentleman from HSBC said that, at least in their experience, their large short on the futures markets was against some cash positions in London, that they were in vaults and so forth. Could you help us just understand, I'm still a little confused as to what the business model -- why would a large merchant hold so much physical inventory against a short that seems kind of constant? I mean it's not like it's changing, you know, so I'm curious.

DOCTOR JARECKI: Well, I think there are a number of different businesses involved in the Hong Kong -- gave a good summary of some of those. Let me give you one or two of them. There's a great deal of lending of metal that goes on from merchants to jewelry, fabricators, and to silver film producers, for example, and so they buy the metal, sell it forward, and lend the metal out to people who don't want to take the risk of metal because they want to fabricate jewelry, and then shortly before they are going to sell it, they buy in their hedge and sell the jewelry, so that requires physical stocks.

The same to some extent is true of what is called cash and carry. There's a question raised why this happened, for example, in the copper market, that there were large stocks of copper and yet unusual prices. Well, there are people who buy copper and sell forward copper and other metals forward because the carry is sufficiently high, three, four, five percent they can get to, and those of you who are familiar with the finance markets know that it's very hard to get even one percent.

In other words, you're able to have a fully secured essentially collateralized loan which you're getting three percent on. These are important differences for people. Equally, they will buy metal in one facility and sell it in another by an arbitrage differential. Mr. Epstein pointed out that there came a moment where, as a result of sales or as a result of market movement, one market went lower than the other market, and sure enough, that's exactly what has happened over centuries, people have moved precious metals, particularly from a market where it was under priced to another market where it was over priced.

So there are any number of events that happened in the metals markets, and perhaps in other markets, but I'm most familiar with the metal markets.

CHAIRMAN GENSLER: I thank you, and Commissioner Dunn.

COMMISSIONER DUNN: Thank you, Mr. Chairman. And this is, indeed, a great panel. Some of the panelists have repeated here. Doctor Jarecki, I appreciate now the tutorage in Greek. After getting the Latin, I think after hearing you the last time, I went back and polished up my Latin from being an alter boy, and I was still waiting for some of the regulators to come out and say mea culpa -- mea max culpa because there has been the fault of the regulators in the meltdown that we've had and it's time that we do something about it, so I appreciate that. Mr. Murphy, I know you had a distinguished career in football, and I think if you give this up, you can become an auctioneer. That was a great speed reading there of getting through that.

And my good friend, John Lothian, who claims the last time I pronounced his last name with an M on the end, wrote in his blog, how would Commissioner Dunn like it if I spelled his last name with an M, so I have to be extremely careful here as I stumble through questions that I'm asking.

But I'd like to get each of the panelists to respond to one of my major concerns, and that is, if, in fact, we put position limits in these markets, does it not, in effect, do the same thing that happened in the Modernization Act, where Congress told us don't look at over-the-counter trade and allow those things to go to an opaque marketplace and diminishes our ability to understand what is actually happening, and I'd like all of you in whatever order you'd like to to respond to that.

DOCTOR JARECKI: I am completely concerned about that view. We have this notion in America, because we only look at our futures markets, many of us, and we think, oh, well, that's a pretty big market, but in truth, as we heard today, the London Bullion Market Association is in many ways already larger in the gold market than COMEX is, the CME is, certainly the copper market is substantially larger.

The COMEX copper market, let's put it in English, I've been a director of that, I'm not trying to offend them, but it is a market that is struggling. The CME market is a struggling market, and to do one more -- it's one more nail in the potential coffin. There are a lot of people that wonder, will there be an American copper futures market.

But it is easy for us to chase markets overseas. Again, I want to speak to, since the Chairman took me to my 17th century roots, the gold and silver markets moved from a port of Spain to Antwerp, from Antwerp to Amsterdam, from Amsterdam to London, and they did so largely because of regulations, first from the inquisition, most of the gold dealers moved up north, and then ultimately moved to London for different reasons relating to the diamond --

But markets do move, and they stay where they go until there's a good reason to go somewhere else. We're giving markets a good reason to move somewhere else. The parent sweet market, since these discussions happened, has increased many. There is currently, I think it's ES&P is putting together an index made up only of offshore markets, and it says we're doing this in case over regulation happens in the United States.

It is easy for us to chase markets overseas, and we will -- I'm somebody who's heard for the last 30 years every little thing that we do, oh, we're going to chase the markets to Europe, they said that about taxes, and they said it, you know, one thing or another, I never paid attention to those things.

This thing I think is real and it's happening as we speak. There are many markets that are already larger than the American markets, and certainly the Chinese markets, many of which are bigger in many areas than ours today, and we ought to look at all of those together. Thank you.

MR. CALLAHAN: If I may, Commissioner Dunn. My boss, Duncan -- had the unenviable job of following in Chairman Gensler's footsteps two weeks ago at the Boca Raton conference after a great speech where he used Mrs. O'Leary's cow as a metaphor for what happened during the financial crisis, so we have been strongly supportive of the general direction that you have proposed in terms of derivatives regulation. But there certainly are a number of push me, pull you's going on. Certain of the proposed pieces of derivatives reform are pulling markets out of the opaque OTC markets and into the transparent centrally cleared exchange environment, and I think we would all support that as a goal in the wake of the financial crisis.

Certain elements, and I'd probably put federally mandated position limits, at least if they're applied perhaps incautiously, would be of strong force in the other direction that would keep transactions away from central clearing, away from exchanges, and maintain the status quo, which I think would be unacceptable to a lot of people in this room. So at NYSE Euronext, Commissioner

Dunn, we share your concerns.

CHAIRMAN GENSLER: And if I could ask, just because our time is, you know, management is to us, if you want to comment, if it's different, yes, but if it's sort of in the same vain, we might move on to Commissioner Sommers. No, Doctor Jarecki has already commented.

MR. NORRISH: I would say that I think there is a danger of that, and I think it would be a shame. I mean you mentioned when you introduced me that there are a lot of my charts with CFTC data, and I think what you have in the U.S. is, you do have a lot of transparency, you do have a lot of data which enables analysts like me to make sense of what's going on in the markets.

And, you know, the global metals markets are concentrated overseas. The Shanghai futures market now accounts for 40 percent of global metals trading. There's far less information available on what's happening on that market, but I think the danger is, if there are limits placed on U.S. futures markets, that's what will happen.

And then from an analyst point of view, the great data that you're providing becomes much less useful to us.

MR. LOTHIAN: I would just add one thing, and that is that in the last several years, we've been banging away on speculators here in the United States and their role in the market, and at the same time, around the world, we see other futures markets maturing and being dominated by speculators, many of them small speculators, particularly in the Asian countries, so I think that there's a risk, if you limit the amount of speculation here, that it will grow other places, because it is already.

MR. MURPHY: (off mic) I think position limits would be -- be the concentration of the big shorts, and then to get into the exemption issue, because if the -- there's no point in having position limits if the big boys can do whatever they want and there's no way to really know what they're doing.

CHAIRMAN GENSLER: Commissioner Dunn,

thank you. Commissioner Sommers.

COMMISSIONER SOMMERS: Thank you, Mr. Chairman. I don't have any questions, but just to say that I appreciated that last question by Commissioner Dunn, and I think it's important for us to weigh those kind of unintended consequences as we weigh the complexities of these issues, so thank you to this panel.

CHAIRMAN GENSLER: Thank you, Commissioner Sommers. Commissioner Chilton.

COMMISSIONER CHILTON: Mr. Callahan, you have position limits, you used position limits, correct?

MR. CALLAHAN: Yes, sir.

COMMISSIONER CHILTON: Okay. Now, that's in the U.S. you have position limits, you don't do it on NYSE Liffe in London, right?

MR. CALLAHAN: We don't trade precious metals on --

COMMISSIONER CHILTON: But on any other contracts in London, you don't have position limits, right?

MR. CALLAHAN: I'd be happy to send you -- we do have position limits on certain of our contracts in London, I'd be happy to supply those to you.

COMMISSIONER CHILTON: Okay. So you have position limits in London, so this talk about, well, we're going to send markets overseas, without even knowing what level we would set the position limits at. For example, say you set the level at five times the accountability level, our proposal in energy we said would only impact, given what had happened historically, several traders, the numbers were between ten and I think 27, so it's not a huge number of traders.

So the concept of a position limit, for all these fears that we're going to lose markets, that we're going to -- it's going to go OTC, it's going to go overseas, we're going to lose liquidity, our kids are going to get kidnapped, I mean it seems to me that it's really the level that we would set it at. If you screw it down so much that people didn't have an avenue, but if you

-- but as a general concept, if the levels were so high, it might be ineffectual, but just the idea of a position limit I don't think should be so ugly scary. The concept to me seems like a solid concept. So I like having the possibility of a system.

Now, Mr. Callahan, you come up with these position limits, as you just said, overseas and in the U.S., and how do you set those? What, for example, is too much concentration in a market? What's too much concentration in a market?

MR. CALLAHAN: Well, I'm the CEO of our U.S. Exchange, and so I'll speak specifically to that, and as we look at the position limits that exist in our U.S. precious metals contracts right now, we are a very small percentage, as we are young start-up exchange right now, roughly five percent, give or take, of the U.S. precious metals market. So we have set those limits, they're actually the same ones we inherited when we acquired this platform from the CBOT.

We examined them when we acquired the platform and determined that, relative to the size of our market, and more importantly, relative to the size of the U.S. Market, that they were adequate.

COMMISSIONER CHILTON: I mean you even make a point I think in your testimony that perhaps smaller or start-up exchanges should be exempt from these position limits for competition, but you have them, they already exist, and do you think it's working out well for you?

MR. CALLAHAN: It's working out well, but I'd make the important distinction between a federally mandated position limit and one that is administered by the exchange. We are --

COMMISSIONER CHILTON: Why? Because you can -- I mean Mr. LaSala said we're closer to the markets and everything, I mean isn't that our job, to be close to the markets, too?

MR. CALLAHAN: I would say that we're in a time of unprecedented change and hopefully we're going to be seeing multiple OTC products migrate towards exchanges if that's the case. What we now consider the exchange traded market could increase substantially. And I think the exchange is in a very good position to monitor and adjust those as needed. My concern would be that if they were federally mandated, they would be much less flexible, and you could see the situation where, again, you're pushing transactions away from the regulated transparent markets or into one of the 14 odd global exchanges that currently trade precious metals. As Mr. Lothian correctly said, it is the ultimate global commodity.

COMMISSIONER CHILTON: I'm pleased that you have them. I commend you for them. I agree that these are unprecedented times, and specifically because of these unprecedented times, I think what we've seen over the last ten or 11 years is that government actually needs to step up and be part of this. And that's to say nothing negative about you, again, I commend you and Duncan -- for doing a good job, but it seems to me we've got a public responsibility to protect consumers.

We have a motive here that doesn't involve the word "profit", it involves consumers, and traders, and people that are part to these markets, so I think it's our job to get involved in this. I see my time is about to expire, but I would like Mr. Norrish to -- you're not going to be able to respond right now, but think about it. The question that I asked, I don't know if you heard it from HSBC, Mr. Charles, about trading for your own book under exemptions and could you separate that trading, so I'll try to ask you when we get around next time. Thank you.

CHAIRMAN GENSLER: Thank you, Commissioner Chilton. Commissioner O'Malia.

COMMISSIONER O'MALIA: As the newest member, I generally find most of my questions have already been asked. But also as the newest member, I'm trying to understand the relationship we've had with agricultural products that have had position limits for a very long time and they experienced some very record price increases in

2007/2008, and I'd like to get everybody's views on how metals position limits, in light of the AG demonstration, what would happen, do you think, if we put position limits, would we be spared price increases, what would happen?

MR. CALLAHAN: Commissioner, as part of my written testimony, we did submit a chart on the back that looked at one year price increases of commodities that had federally mandated position limits versus those that doesn't, and it was actually data that came from the CFTC. I think the conclusion one would draw from that CFTC data is that it is inconclusive that federally mandated position limits are an effective tool for moderating excessive price movement.

MR. NORRISH: Yeah; I think the result of that would probably be, we've seen volatility in agricultural markets, so I think that's -- it's clear that position limits don't necessarily act to take that volatility out. My feeling is that, you know, the most efficient markets are the bigger ones, the U.S. agricultural markets are relatively small in a global scale, but the most efficient markets are the bigger ones, the industrial metals markets are very big and they are liquid, and if you put position limits in that start to remove that liquidity, you're not going to smooth out prices, you're probably going to end up making them more volatile in the short term.

And my concern also is that if prices are artificially pushed down, even if it's only for a short period of time, that has longer term implications for the supply side of the business, as well.

We need to see a lot of growth in supply on the industrial metals side, and my concern would always be that if we take liquidity and risk management ability out of the financial markets, then we're not going to get the growth in the physical markets that we really need.

COMMISSIONER O'MALIA: Doctor Jarecki.

DOCTOR JARECKI: The question is whether -- what the impact of position limits would be, both on prices and on volatility. I think that the -- all the evidence that exist is that the high prices that have been seen in the last years existed in all markets, not only in futures markets, but equally in steel, and iron, and rhodium, a lot of things just ran up, and they ran up to some extent together with or separate from.

What had happened really was that the government has printed so much money, that money is going into something, and we see -- it must go into commodities or real estate or one thing or another, and that's what brings prices up. And I don't think whether they're on an exchange, not on an exchange, is that relevant, except that an exchange moderates it because there are more people involved.

Certainly, being on the exchange lowers volatility, that's been seen everywhere. The high drama of two or three decades ago, about four decades ago about onions, the onion market has been a disaster since it was taken off the futures markets. And I understand that there's a congressional mandate on the topic, but the truth of the matter is that volatility is diminished when things are placed on exchanges because there's simply so many people looking at it and saying, that price is too high, this price is too low, and taking actions on it. So my view is, it'll increase volatility and it won't effect prices measurably or predictably.

MR. LOTHIAN: Any time you add friction to markets, you're retarding the price signal, and the price signal is very important for producers, for consumers and the like. And when you're talking about the types of challenges that we're facing that have been outlined here in terms of the amount of investment that we need, okay, the higher prices are signaling to us, we need more production, we need more selling, and we talked about this before.

And so anything that you're doing to retard that and say the prices should be lower, we need to restrict this, you know, not let it get to its free levels, or we're going to -- it's going to swing over here to the over-the- counter because it, you know, can't find its natural equilibrium in the futures market, all of those things hurt that price signal. And futures markets are ultimately about two things, price discovery and risk transfer, okay. So -- but the first and foremost is the price discovery, so you want to look at what it's going to do relative to that equilibrium.

COMMISSIONER O'MALIA: We might want to give Mr. Murphy the last --

MR. MURPHY: I'll get the hang of this yet. Anything that will limit the ability of the big bullion banks to bully the market will be a big plus and will lead to greater price discovery.

CHAIRMAN GENSLER: Thank you, Commissioner O'Malia. I don't know if there are other questions, I just wanted to say a few words on mine. Great, so we'll do another round, even better. And I suspect there will be a blog on this when I -- it did differ a little bit with Mr. Lothian. But you mentioned that friction retards -- anything that's friction retards the price signals in the market, but I think that we live in a nation that we benefit from regulation in the securities markets, and certainly when any issuer has to file a 10K or a 10Q, somebody could say there's a cost in that. I think that we benefit in a nation of laws. We have traffic lights, you could say a green and a yellow and a red light is friction, it does slow down traffic, thank God, so --

MR. LOTHIAN: Running into another car is also friction.

CHAIRMAN GENSLER: What's that?

MR. LOTHIAN: Running into another car is also friction, so I agree with you.

CHAIRMAN GENSLER: Absolutely; so I think that we do benefit by having a regulated market economy, and then people like us get in these jobs and we have to sort through and have hearings like this to see where we come out. To me, it's not about prices. I appreciate Commissioner O'Malia's question and I think it was a very good question.

To me, it's a question of the position limit authority that we were vested with in the 1930's, it's to promote these fair and orderly markets, and my central questions in this hearing has been about concentration because that's what at least I'm interested in, is, do the silver markets and gold markets with the higher concentration that they have, and sometimes very high concentration, are those, you know, the best functioning of the markets, do they bring that price discovery function together?

Onions, by the way, I think was in the 1950's, and I think it was a Congressman from Michigan named Gerald Ford that was involved in it, but -- what's that? And Commissioner O'Malia went there. I want to associate myself, because I don't have a question, I'm just going to associate myself with Doctor Jarecki's comments earlier and maybe appropriate them in later hearings. I think that we have found in the futures markets a rational way to deal with leverage, I think that was the words you used, that the clearing mechanism invented in the late 19th century has survived through two World Wars and Great Depressions and many bank failures.

It's not perfect, but I think it works well, and that's why I'm so much -- believe we have to bring it to the over-the-counter derivatives marketplace, as well, and I thank Mr. Callahan's comments, that I think if we can bring the transparencies, well, that's going to be big. But Commissioner Dunn.

COMMISSIONER DUNN: Thank you, Mr. Chairman. I said during the position limit meeting on energy, for the large meltdown, that I thought three things ought to happen, there ought to be more transparency in the marketplace, that we need some type of reimplementation of the -- Act, and that we needed to implement anti-trust, and since then, the administration has come out with the Volcker rule, which I think is a good direction to begin looking at. Mr. Norrish, I've just finished Secretary Paulson's book, On the Brink, and everybody takes away what they want to take away when they read something like that, but my take away from it was that we had too many large financial institutions that were way too leveraged and exotic instruments, the securitization that they didn't understand that was a major problem as that housing bubble burst. But you're advocating here for us to have large financial institutions in there. Could you tell me why we're not walking into the same problem again?

MR. NORRISH: Yes, I can. I think, you know, the first point, in answer to that question is, you know, we've had large financial institutions operating in the commodities markets over the last couple of years, and the commodities futures markets have been amongst those that have worked best.

There hasn't been a lack of liquidity, there's been accurate price discovery, and there hasn't been the distress in the commodity markets that we've seen in many other financial markets, so I think that's an important point.

I think the other thing I'd say is that it isn't the nature of commodity markets that risks tend to be very large, they tend to be very lumpy. If you're building a new copper mine in the middle of Africa, that can cost $10 billion, and you may be producing 300,000 or 400,000 tons of copper every year. So you're trying to manage very large risks, and they can come into the market at various times with unpredictability, and if we don't have large financial institutions that are able to take on those risks, that perhaps are able to warehouse them for some time, that are able to feed them out into markets gradually and to use lots of different ways of doing that, over-the- counter markets, futures markets, and physical markets themselves, then I think, you know, you risk possibly the kind of volatility and market disruption that we've perhaps seen in some of the other markets over the last couple of years or so.

So I think that role that the big financial institutions play in being able to absorb those risks, to ameliorate them and then to gradually lay them out into the markets in a controlled way is actually a strength of the commodity and it's probably one of the reasons why those markets have worked well over the last couple of years.

COMMISSIONER DUNN: I still have concerns about the interrelationship between those institutions and the other systemic risks that we may get at the end of the day. Let me get back to my previous question on -- and again, during the energy meeting, I said that we ought to look at getting the over-the-counter authority, which I think is very, very important, but the other aspect I said is that we needed to begin harmonizing our regulations with our sister agencies around the world.

And I want to, Mr. Chairman, at this point give you a pat on the back for the great job you've done the last couple of weeks trying to sell that concept in the EU. I thought that was a tremendous opportunity or a great job that you did of bringing this issue to the forefront, and, to me, I don't want to go forward unilaterally, I want to go multilaterally with other regulators around the world, but I also want to see that over-the-counter market.

Again, I would like the panelists to respond to, if, in fact, we get OTC authority to regulate that, would that be a point in time where we could go ahead and put in position limits, or should we wait until we actually have Congress -- have the ability to promulgate a regulation, and should it be doing those unilaterally, the OTC along with a position limit? Tom.

MR. CALLAHAN: Thank you, Commissioner. I'd just like to set the record straight on an error that I made in my previous statement. We actually have no position limits in Europe. I thought there may have been one or two contracts that had those, but we do rely on the FSA's position management process, so Commissioner Chilton, I apologize for that, that was just a mistake on my part.

I would say that, especially as a global exchange operating in Europe and the U.S. in both the derivatives markets and in the cash markets, the idea of regulator harmonization is an essential first step on things like position limits because it's just very, very easy for these markets to move to foreign jurisdictions.

As I said, I think there's 14 exchanges globally that trade gold right now. And if the U.S. position limit regime is particularly strict relative to others, it would be very easy not only for the gold markets, but for other markets, as well, in the world of electronic trading, for them to very easily move to foreign jurisdictions where they'd be out of reach of this Commission, so I would share your concern on that front, as well.

COMMISSIONER DUNN: And on the timing of us, if we, in fact, do go forward with a position limit rule, if we have over-the-counter authority, should we wait until we are promulgating both rules simultaneously?

MR. CALLAHAN: Well, I'm not convinced

that federally mandated position limits are required, but if they are determined by the Commission to be required, I think that doing that simultaneously would be the best course of action.

DOCTOR JARECKI: The question of -- it's obviously correct that it is -- that any regime that limits only the position limits on the U.S. futures exchanges won't be maximally effective unless you can regulate also or participate in regulations. You pointed out the Chairman is seeking to do with overseas markets and also by getting authority for the over-the-counter markets, otherwise, it's simply a constraint of the American futures markets.

But I think you have to recognize one other things, which is -- it has to do with the physical markets. And here I think we should specifically speak about the metals markets, because it's in the metals markets, in gold, silver and copper, where it is trivial to own physical material.

Certainly, those who, like our

customers, pay 100 percent margin, for them it's easy to put down 100 percent margin and buy gold, silver or copper and leave it in warehouses, and many people do that. As a matter of fact, the bullion market operations in London, where people have physical bars, they're much -- they're very large, and many institutions want that. The issue of gold and silver has to do with trust in currencies in large measure, and the people who don't trust currencies, they don't want several levels of obligor, they don't want their broker to stand between them and the metal, they don't want their broker and an exchange to stand between them, their broker and an exchange and a clearinghouse to stand between them and large positions where a large institution could fail.

Especially people who worry about inflationary matters, they want physical assets like gold, silver, copper in warehouses, things that don't spoil, things that are easy to transport, and for that reason, I think you have to focus on the fact that even when you have control of all the rest, especially in the metal markets, you're going to risk that people move things into warehouses, and now you will actually have price impacts, namely, there will be shortages and prices will go up by leading to large physical storage, whereas the simple trading back and forth in the futures markets will not have an influence on the physical prices.

CHAIRMAN GENSLER: Thank you, Commissioner Dunn. No questions. Commissioner Chilton.

COMMISSIONER CHILTON: I want to go back just a little bit, Mr. Callahan, before I get to Mr. Norrish and Mr. Murphy. And also, Commissioner O'Malia talked about the AG limits, and met on the panel to answer that question, but I mean my view, and perhaps our last panelist, Mr. Masters, could speak to this, is that since this agency has existed, there has been position limits in AG, and so, yeah, there's been a lot of volatility in the AG markets in the last couple of years, but there's been a lot of volatility in markets in the last couple of years. So I think, by and large, they've acted pretty well.

The new thing is this $200 billion that came into the markets, you know, up until 2008, and in my view, you know, having some contributing impact, I'm not saying driving prices up or down, but having some contributive factor, the new speculators, and this is different in the metals, but in AG and in energy, these massive, passive investors differ in metals.

But, Mr. Callahan, I want to make sure I'm clear that, while I commend you for having the position limits, I also think you're right on target with regard to having the flexibility to set them in an appropriate way. And one of the things that I guess I do, and if I were setting this whole position limit thing myself is, have it so that we are also flexible in working with you in tandem to make sure that we do have the right thing, the size of the market, what's going on.

You don't want to slow down, you want to -- we do want to make sure that we're adaptive regulators and adaptive exchanges so we don't lose market share. But I actually think that it's the contrary to what some of the witnesses have said.

I think this builds confidence in markets, having sideboards, so that we still have free markets, but they're rational free markets with just some parameters, and again, it's how you set them that is the problem, I think, not whether or not they should exist, because you can set them so high that they'd be ineffectual in any regard. So I wanted to make sure I'm clear on that. I agree with what you're doing and I'd like to join you in that effort. Mr. Norrish, can you give us sort of a succinct response to what I was asking Mr. Charles earlier?

MR. NORRISH: I'll try and keep it succinct.

COMMISSIONER CHILTON: Thank you.

MR. NORRISH: I think your Treasury Secretary, Timothy Geithner, has summed the issue up quite nicely actually when he said that it can be very difficult to distinguish between what is a hedge position and what is a speculative position. And he gave the example of a farmer, for example, who sells forward what he expects to be his corn crop for the next harvest, and through bad weather, it turns out to be much less than he thought, so he's over hedged. Now, is that, you know, that's entered into in good faith, but is that a hedge position or is it a speculative position?

What I would say is, imagine that situation multiplied many thousands of times, that is the situation that the large financial institutions are dealing with in the day-to-day activity of managing the real risks of producer and consumers.

They are managing a very large and interconnected portfolio of all sorts of different trades. And the ability of those kinds of institutions to provide those risk managing services at low costs very much depends on their ability to do that with a lot of flexibility, and that --

COMMISSIONER CHILTON: Could you separate it, though? I mean it would be a pain for you, but could you? As I mentioned, there's -- one bank has told me that they could do it; could you physically do it, could you figure it out?

MR. NORRISH: I work on the research side and I don't have the experience of managing those very, very large positions. I think it would be an extraordinarily complicated thing to do, and I think, you know, it would take away the flexibility that is required, as I've said earlier, to manage those very big, large, complicated, lumpy risks that come into these markets with a great deal of unpredictability.

COMMISSIONER CHILTON: Okay.

MR. NORRISH: And I think that's the key issue.

COMMISSOINER CHILTON: Thank you. You know, it makes me think about the -- we have -- saying that it's so complicated, first of all, I grant you, your example of South Africa, I'm not saying that we shouldn't have exemptions. I think large financial institutions can be very important, so I'm not saying there are no exemptions, but I think they need to be targeted, and so I'm not particularly comforted by the fact that it's so scary complicated that we couldn't tell you. To some extent, that gives me a little bit of pause. I don't know what the exact right answer is, because I accept your premise that it's -- you do important work, but saying it's too complicated to figure out gets me a little queasy. Mr. Chairman, I do have a question, which I'll stop now, but I do have a question for Mr. Murphy at some point, so thank you.

CHAIRMAN GENSLER: Why don't you do it.

COMMISSIONER CHILTON: Thank you, I appreciate your patience and indulgence. So, Mr. Murphy, you know, you've been fairly critical of COMEX and saying that they've been complicit, I guess, in suppressing prices, but can you give the Commission some specific evidence, some specific examples of how you think that's occurring, when you think that's occurring?

MR. MURPHY: Yes, I can. And I had 11 years worth of evidence, it all hangs together here, but something came to my attention two days ago of a whistle blowing nature that we're going to hand to the press afterwards, and we think it's very important for the American public and this hearing to have this information. On March 23, 2010, GATA Director Adrian Douglas was contacted by a whistle blower by the name of Andrew Maguire. Mr. Maguire, formally of Goldman Sachs, is a metal trader in London. He has been told firsthand by traders working for JP Morgan and Chase that JPM manipulates the precious metals markets and they brag how they make money doing so.

In November, 2009, he contacted the CFTC Enforcement Division to report this criminal activity. He described in detail in which the way JP signals to the market its intention to take down the precious metals. Traders recognized these signals and made money showing the metals along side JPM. He explains how there are routine

-- option -- non-fair pay releases, and COMEX contract rollover, as well as other ad hoc events.

On February 3, he gave two days advance warning by email to Mr. Eliud Ramirez, a senior Investigator of the Enforcement Division, that the precious metal would be attacked upon the release of the non -- payroll -- on February 5. Then on February 5, as played out exactly as pernicious, predicted further emails were sent to Mr. Ramirez in real time while the manipulation was in progress. It would not be possible to predict such a move in advance unless the market was manipulated. In an email on that date, Mr. Maguire said, it is common knowledge here in London amongst the metal traders, it is JPM's intent to flush out and cover as many shorts as possible prior to any discussion in March about position limits. I feel sorry for all those not in the loop. A serious amount of money was made and lost today, in my opinion, as a result of the CFTC by your own definition of legal concentrated manipulated position allowed to continue.

Today is April -- option expire in the COMEX. There was a large open interest in strikes from 1100 to 1150 in gold. As always happens, month after month, HSBC and JPM sell short, and large -- overwhelm all bids and make unsuspecting option holders lose their money.

As predicted in advance by GATA, the manipulation started on March 19th, when gold was trading 1126; by last night, it was down to 1085. This is how much the gold cartel feels the Enforcement Division. They thumb their noses at you because -- complaints in 18 months of the silver market manipulation investigation, nothing has been done to stop them. And this is why JPM's cocky and arrogant traders in London are able to brag that they manipulate the market. It is an outrage and we are making available the emails from our whistle blower, Andrew Maguire, to the press, where -- advance on manipulative event. Additionally, Mr. Maguire informed us that he has taped recordings of his telephone communications with the CFTC for which we are taking the appropriate legal steps to acquire.

COMMISSIONER CHILTON: All right. Well, that was more specific than I anticipated, but I thank you for it, sir, and I thank you for the indulgence. Again, I don't want to talk about any individual circumstances that the Chairman discussed earlier, but thank you.

CHAIRMAN GENSLER: Thank you, Commissioner Chilton. Commissioner O'Malia.

COMMISSIONER O'MALIA: Doctor Jarecki and Mr. Lothian, in previous testimony, Mr. Epstein testified that the oversized market position of market makers had a chilling effect on the liquidity in large orders wind up setting prices; could you comment on those concerns? And if you can keep it short because I have another question.

MR. LOTHIAN: Sure; you know, what he didn't say was that what a market maker does is harass large orders and try to work themselves against them, and join the bid, and join the offer, and use the market data that he's getting about the other orders in order to -- for where to position himself. And so a large order, you know, all of a sudden there's nobody offering at this price, I offer, you know, a couple hundred contracts, all of a sudden it's 400 contracts, okay, and depending upon the algorithm that's used in the market and all that.

There are also very -- lots of instances where people want to come in and just execute all at one time, whether it's a CTA that wants to just get everything done for a client all at one time and not have any execution risk, you know, I mean price is price.

There's also instances where large traders like to play with the market makers to teach them a lesson every once in a while, and that's -- those things occur, as well. So there's lots of different reasons why a particular trader may come in. It could be a stop that was in the market, and, you know, they expected better liquidity in there when that order was hit, and it just went down so suddenly.

And had they reflected upon it and been able to execute it over time better, then they probably would have been, but they were expecting better liquidity in there at the time.

DOCTOR JARECKI: I'm sorry, I'm terribly sorry, I didn't understand what Mr. Epstein said. I understand that his work is high frequency trading, and I didn't understand what one could, in a machine system, do and how somebody could sell several thousand lots, find a big price drop. Doesn't the person who is selling all those lots ultimately get damaged because his last lots are sold very much lower than the then prevailing or the logical market? I didn't understand what he said, frankly, and so I can't help.

COMMISSIONER O'MALIA: That's all right, we'll give you a shot at the next question. In your testimony, you laid out four recommendations, and one of them sounded like -- you talked about a look through to identify the end user, and I assume you meant for bona fide hedge exemptions. In the energy position limit proposal, we have a dealer proposal that's two times the limit, and I would ask you to comment on what you think of that proposal, and then potentially does it relate to this look through proposal you have here in your recommendations.

DOCTOR JARECKI: Well, I'm not sure that it makes sense to have position limits on dealers who have certain features, such as not being leveraged so they can't really be part of a speculative system not operating in the spot month, so they can't -- so their positions cannot be relevant to a squeeze, where all of their information and their advice to people is public information so it's completely transparent and it's all on exchanges and they have no positions of their own.

It seems to me irrational to have any position limits. I'm very pleased that, if there were position limits, one would think of there being larger, double the size perhaps for someone in that situation. But ultimately, it should be -- fall into the position limits of the ultimate buyer, and if you don't do that, you can get an ultimate buyer who is free of being looked at, and he could buy five different futures funds and have position limits larger than are intended.

Now, what I've seen of the energy limits, and there I reflect on Commissioner Chilton's comment, it is, of course, from a practical standpoint, and as you -- of what the size of these limits are. But it is -- I have to say, in listening to some of the Commissioners today, it's as if regulation is good for its own sake, rather than understanding that traffic lights are there to stop people from killing each other, and that the SEC's goal was anti- fraud. Everything that this agency can do to prevent fraud, to prevent excessive speculation or manipulation or delivery squeezes, all that is wonderful, and transparency is wonderful, once you know who the people are. I don't even know whether I strongly object to this idea that there should be something like the SEC. If you have more than five percent of the open interest, maybe you ought to tell somebody about it, maybe you ought to have an obligation, I don't know. That one I haven't thought through before today.

But I, you know, but the idea that it's -- let's have some regulations because regulations are good for you, that I'm afraid I can't take on.

CHAIRMAN GENSLER: Commissioner O'Malia, thank you. I don't have any other questions, but I think Doctor Jarecki is always inviting me to reply. And we have --

DOCTOR JARECKI: Thank you.

CHAIRMAN GENSLER: -- a nice -- I believe that the American public benefits by our market based economy, but it's a regulated market economy, it's not regulation for regulation sake. I think traffic lights do help in a complex network, we call it the highway network or the -- if you go down any street on Main Street, it doesn't have to be New York City or Washington, but Main Street, you're glad there's traffic lights. And so I think this complex financial network also, it's appropriate to have traffic lights, and that's what we're trying to do, we're trying to reach out and trying to understand from the public through hearings like this as to whether we might re-establish position limits.

You know, we did have them in a period, you probably were active in the markets in the '80's and early '90's, in this metals market, so that's what we're trying to understand. And it's not about prices, to me at least, it's about making sure these markets are fair and open and orderly, and it's a question of concentrated positions and whether that's a beneficial side or not.

I would like to ask Mr. Callahan if it's possible if you could follow-up. I would be interested to know from New York Stock Exchange your next, you know, what sort of position management regimes that you're under, not position limits, but position management you might be under in London, it would be terrific to learn that. But there might be a question, so --

COMMISSIONER DUNN: I'd just like to

follow-up on my last question about the timing on regulations with Mr. Lothian, because he did have that in his testimony about over-the-counter. John, if you would, please.

MR. LOTHIAN: Right; you know, ultimately, I think if you're talking about the over-the-counter market and you're getting responsibility for the over-the-counter market, you're only getting a piece of the over-the-counter market, and you're only getting a piece of the world futures trade. So it's not just a question of aligning U.S. futures and U.S. OTC markets. I would urge greater transparency there towards fostering a better understanding about the markets and the risks.

Until you get global regulators to agree to some kind of a position limit or a greater transparency scheme or something like that, putting them here would be just putting us in a bad position too early.

So, again, I know you're trying to work, you know, globally on this, and I would continue to urge -- to work globally on this, because, you know, I mean if China has three times the demand of the copper market, or of copper production, why should that market be here, and why is it not going to be somewhere over -- somewhere else? You know, and they're building markets and the area is building markets, so maybe it should be over there and maybe it will move over there. So you have to look in that broader scheme is what I'm saying.

CHAIRMAN GENSLER: I'd like to thank all five of the --

COMMISSIONER CHILTON: I apologize.

CHAIRMAN GENSLER: No, I didn't know.

COMMISSIONER CHILTON: I'll be brief. Look, I mean this thing about, you know, waiting for other countries, I think there are some legitimate concerns there, but somebody has got to go first, and we've always been leaders, and you know, I think as long as we are cognizant of what we're doing, and again, it's the levels, and I appreciate Doctor Jarecki sort of acknowledging in a little way, even though I know you don't agree with the concept of position limits, that it's somewhat the level.

So my quick question for you, Doctor Jarecki, is there a level at which you say enough, I mean, you know, 20, 30, 40, if you have 51 percent, is that too much, or is it just such a bad concept that we should just let the free markets roll?

DOCTOR JARECKI: I don't know what the percentage would be of, and I -- my comment before about even transparency and letting people know if you've got a very large part of the soy beans of the world, I don't mean just a soy bean open interest, but if you own 20, 30 percent of the soy beans in the world, you're in a special and unique situation, and maybe people ought to know that before they trade, because otherwise, you know, you're, you know, you can get taken advantage of by those who do know those. Not even the owners necessarily. Let everybody know the same stuff.

And I was really speaking, Commissioner, more of the practical implication. If you have a practical implication that is so high that it's irrelevant, so be it. But then I fear you are just embracing the concept, well, regulation is good for its own sake, but if that were true, you might as well regulate the color of clothes people wear on the exchange and say, well, they ought to be regulated, they ought to not have this, and then you could regulate what their hours would be and whether they go out to lunch.

COMMISSIONER CHILTON: No, that's a mischaracterization, like the Chairman said, too, that's -- I thought we were reaching some sort of common ground, but that's going the other way.

CHAIRMAN GENSLER: Thank you very much.

DOCTOR JARECKI: Sorry.

CHAIRMAN GENSLER: As I was saying, I was going to thank the panel, wonderful to hear from each and every one of you. And I think if we can invite the other panelists up, as it inevitably will probably take us, you know, five or eight minutes just to sort of circle through here, and if you do leave and come back, there's some security that's still there.

(Pause)

CHAIRMAN GENSLER: If I can call us back to order. Commissioner Dunn likes when I do that.

COMMISSIONER DUNN: I'm amazed that it always works.

CHAIRMAN GENSLER: Yeah; I learned it from -- in Baltimore, it does seem to work. I think it's inbred in us. I want to thank our fourth panel, third public panel for being here, their willingness to testify, and their patience as we continue to hear about trading in the precious and base metals markets and the consideration of these issues of possible position limits and otherwise -- I want to pause here for a second just to --

(Pause)

CHAIRMAN GENSLER: But I want to thank and just introduce each of our final panelists. Harvey Organ, who's an investor, now resides in Canada, he has been a very active investor both in the securities markets, stock markets, and concentrating interest in the mining fields, and has been trading, at least from these notes here given to me, for the last nearly 40 years, and has been in other businesses, as well, but we thank him for being here.

Mike Masters, I guess, Mike, it's a repeat performance here, who's founder and managing member of Masters Capital Management. I think it's also appropriate that you're here at this metals hearing because you co- authored with Adam, who I see here, too, Adam White, something called the Accidental Hunt Brothers, so here we have you at a metals hearing, but has been an advocate and appears actively on television, and appeared before Congress a great number of times talking about the need for reform of the over-the-counter derivatives marketplace.

And then Richard Strait, Director of Marketing Strait, LLC, which is a guaranteed broker of Triland USA, which is part of the larger group, Mitsubishi Corporation. And so we thank all three of you for being here. Richard has served on the Board of Gold and Silver Institutes, as well, and numerous exchange committees, and he currently serves as Chairman of Metro, New York Chapter of the International Precious Metals Institute and Advisor of the Board of Triland USA, so he brings a unique perspective on these markets. And so do we have a fourth panelist that's supposed to be here? Oh, by video conference, I apologize, that's right, we're using modern technology.

So Jeffrey Christian, Managing Director and founder of CPM Group, which is a commodities research firm, and he's been doing this for now nearly three decades, commodities research, and CPM was founded in the middle of that period, and so somehow there we see Jeffrey. So hopefully this works, and if we can -- all your written testimony will be in the record, but if you can give us orally in five minutes. And I don't know if I went left to right, where Jeffrey fits in, but I'll start with Richard, and Jeffrey gets to wait until he's -- he'll be the clean-up hitter here.

MR. STRAIT: As he should be. Thank you, Chairman and Commissioners, it's really a great pleasure to be here to talk to you today about the metals markets in particular, which I have been trading for 30 years, servicing clients both in the futures and physical side of the business, and that would include ferrous and non-ferrous metals. In fact, I had the luxury of working for Doctor Jarecki for six years actually. Anyway, I really -- we've gone over a lot of points that are very easy to pass over, I'm not going to go into great detail about it because I think we've beaten pretty much every horse on every topic, so I'll just make my general statement about my points which is in the record.

And I further want to discuss OTC clearing, which wasn't brought up at all today and where that stands. For example, the very robust platform like ClearPort, that has exercised a significant amount of clearing business and transparency to the marketplace and how that fits into a greater scheme of things with regard to position limits.

And OTC clearing, is this going to be -- does the OTC mandate or the issue regarding OTC position limits, is that going to figure into ClearPort and ICE Clear, for example, and I think that's a very important discussion as we go forward, because you can't have position limits in the futures markets just to run them into OTC, particular a cleared product, you know.

So Doctor Jarecki takes a point where, okay, the real gold bugs and the metal bugs are going to put it in a closet or in a warehouse some place, and, you know, not unlike what China has done, trying to diversify dollar holdings by owning metal over the past year or two actually, non-ferrous metals particularly. So anyway, I'll get to my point about that later, but I just think the exercising of position limits, I'm generally against it, with the exception of front end year by month position limits could be exercised by the exchanges.

I think the CFTC has done a wonderful job of supervising NFA and the exchange activities over the years. And it's been broad testimony today that the exchanges have done quite well regulating themselves with the supervision of CFTC over the last 15 -- 20 years, certainly as long as I've been in this business, which is when the CFTC started actually.

The same story, if you're going to put limits on the markets, you're going to run offshore, for sure, without any question. We have a lot more alternatives than we had 15 -- 20 years ago. There were very few markets available to -- alternative markets, and now there's plenty of them. They reach the Persian Gulf, we've got one starting in Hong Kong now, starting a gold contract, have energy contracts, there's a lot of alternatives for both the investor and the hedger. But I wanted to get to, without going into details about, you know, the reasons why, because I think we've all heard about the reasons why I think positions limits are somewhat misguided, and to compare agricultural position limits with metals position limits I think is -- it's not a one size fits all thing.

Minneapolis red wheat is different from international gold market or silver market, okay. There's only so much red wheat produced to be delivered over the Minneapolis market, and therefore, the agricultural, you know, position limits may or may not be, or certainly seem to be justified, very much so.

But the hedge exemption, I want to get to that for a moment. A bona fide hedger really is -- I'm going to read it because I wrote it and this is what I believe it actually is, is a commercial or financial entity that will possess cash positions using the form of on exchange or off exchange physical inventory or forward physical obligations.

These entities can be producers, manufacturers, stockists, financial intermediaries that service industry related to the underlying futures contracts. A bona fide hedger -- to a bona fide hedger, exchanges are meant to be buyers and sellers of last resort, while speculators are needed to supply liquidity for futures markets to operate properly. They're both equally as important as one another in functioning markets and both continue to be a factor in the commodities markets with or without position limits. The only difference will be that, in the event of strictly mandated position limits, they'll seek, of course, commercial refuge in less regulated offshore markets and/or the global over-the-counter marketplace, creating this dark pool of what we had in the financial markets a couple of years ago.

Okay. With regard to differences Mr. Epstein was discussing earlier in the silver price premium for 100 ounce bars, well, yeah, you know, that's not a metal thing, that's a product thing; 100 ounce bars -- the most desired investor product, and they ran into short supply, so they were running a premium.

Exchanges are meant to be places where

you go shop for -- it's not Walmart, where you're going to go buy a coin or you're going to go buy a kilo bar or something like that, it's a basis contract, it's a basis from which fabricated metals priced, such as Mr. Burghardt's sheet tube and brass products, and it's not meant to be the end all for the consumer, whereas you have, of course, layers of precious metals dealers around the country who can sell coins of small retail product and they are given the ability to have them manufactured and delivered and that's the reason for the delay, that's the reason for the mandated, I guess it's what, 20 some odd days, they're allowed to deliver the product against the contract. Very similarly --

CHAIRMAN GENSLER: If you could just --

MR. STRAIT: Oh, I'm sorry, I'm going over my time here. Anyway, I want to get back to the ClearPort, if I can. How is it --

CHAIRMAN GENSLER: Can we do it in Q and A then? I'll promise you, I'll ask you about ClearPort.

MR. STRAIT: Yeah, okay, we'll come back to Q and A. Anyway, the point I'm trying to make is that, futures markets must be flexible, and I'm not sure position limits are really the right thing to do, and I'm not sure, I think it's a pipedream to think that you're going to get a broad mandate from foreign offshore -- offshore markets are going to go along with us, because they're going to view this as an opportunity.

CHAIRMAN GENSLER: Okay.

MR. STRAIT: Thank you.

CHAIRMAN GENSLER: Thank you, Mr. Strait. Mr. Masters.

MR. MASTERS: Thank you, Chairman Gensler, and Commissioner Sommers, Dunn, Chilton and O'Malia. I testified before the Commission on the topic of speculative position limits at the August 15th hearing, and for that reason, I don't want to delve into minutia, but instead highlight a few key points regarding position limits with a special focus on the metals markets.

First, position limits can serve two

potential roles, the role of manipulation mitigation and excessive speculation prevention. Manipulation occurs when a small group of traders wheel large positions in order to unduly influence the market price. By limiting the size of positions the traders can hold, position limits make it harder for these traders to manipulate the markets.

Regulators can also impose position limits to diminish, eliminate or prevent excessive speculation. Excessive speculation is a state of the marketplace as a whole, where the positions held by speculators, none of whom individually have manipulative intent, constitute such a high percentage of the total open interest that they become the driving force behind price discovery. By imposing speculative position limits, regulators can then reduce the size of speculative positions, and therefore, reduce their dominance over the price discovery function. The goal is not the restraint of any one trader, but rather an overall reduction in speculation. This removes the potential for consumable commodities derivatives markets to experience speculative price bubbles.

Because there are two roles for position limits, there are two distinct methodologies for setting position limits. If the goal is to mitigate the threat of manipulation, regulators should set the level of individual position limits at a specified percentage of total open interest. This will ensure a minimum number of market participants while limiting the ability of any single participant to manipulate prices.

However, if the goal is to prevent excessive speculation, regulators should establish an acceptable level of speculation in the marketplace as a whole, expressed as a percentage of open interest. As a general rule of thumb, speculators should never represent more than 50 percent of the open interest, because at that level, they will come to dominate the price discovery function. For many commodities, the speculation percentage composed only 25 percent of open interest in the past. During this time, there were few complaints regarding liquidity, and we had no commodity speculative bubbles. The ideal of speculation will vary between markets, but 25 percent has been a reasonable level and is a solid starting point for discussions.

Once the target level of speculation is determined, regulators should reduce individual position limits in order to reduce the overall speculative percentage until it falls within an acceptable range.

Consumable commodities derivatives markets are unique because they are susceptible to both manipulation and excessive speculation. Regulators then should calculate position limits utilizing both methodologies and set the speculative limit at the tighter of the two.

Today we need speculative position limits imposed by the CFTC in all consumable commodities derivatives markets. This will force some speculators to exit these markets, thereby reducing their dominance and eliminating the possibility of speculative price bubbles. Copper is a consumable commodity, and therefore, needs speculative position limits to reduce excessive speculation. Concerning precious metals, they can be consumed, but they are more often thought of as investments. It is my belief that gold, silver and other precious metals need speculative position limits only for the purpose of preventing manipulation, not necessarily for the purpose of preventing excessive speculation.

Since gold and silver have been considered currency and stores a value for many thousands of years, precious metals are typically considered capital assets and not commodity goods.

Gold and silver have some industrial applications and a small amount are consumed each year. However, most precious metals are not consumed. For example, as much as 85 percent of all the gold -- is still held by investors. They are not then consumable commodities.

Finally, one more point, the core of our current excessive speculation problem is a passive speculation problem. Like one of those Russian dolls, we have a problem within the problem. The main reason the speculation in consumable commodities has grown so dramatically in the last seven years is the rise of passive speculation by those seeking to "invest" in multiple commodity and single commodity derivative structures. Today passive speculators outnumber active speculators and account for the -- share of speculative open interest in most consumable commodity derivatives. Active and passive speculators are two very different animals. Active speculators add beneficial liquidity to the market by buying and selling futures contracts with a goal of turning a profit. In contrast, passive speculators allocate and drain liquidity by buying and rolling large quantities with an extended duration.

Passive speculators investment strategy is completely blind to supply and demand realities in the markets. As such, passive speculators not only undermine, but actually destroy the price discovery function of the market and make room for the formation of speculative bubbles. The CFTC must address the issue of passive speculation. It will not go away on its own. Thank you.

CHAIRMAN GENSLER: Thank you, Mr. Masters. Mr. Organ.

MR. ORGAN: Mr. Chairman and Commissioners of the CFTC, I'd like to thank you for allowing me to present to the Commission as to whether there's a need for position limits on the precious metals such as silver and gold. The bank participation report of August, 2008, a report which the BIS uses to gauge risks to banks, revealed that one or two USA banks held a massive short position in silver, some 33,805 contracts, or 169 million ounces of silver. In the July, '08 bank participation report, these same two banks held the short position of 6,199 contracts or 31 million ounces. The increase in silver short was an astonishing 138 million ounces of silver.

All mining activity throughout the world produces 680 million ounces of silver. This increase in the silver short represents 20 percent of all mine production. With respect to the total short position of 169 million ounces, this represents 25 percent of all annual mine production of silver. To my knowledge, this is the largest concentration of a short position in any commodity.

In gold, in the July, '08 bank participation report, the summary revealed that three or less banks held a short position of 7,787 contracts of gold or 778,000 ounces. However, in the August, '08 bank participation report, there was a massive 11 fold increase in the short position by these same three or less banks, with the short position rising to 86,398 contracts or 8.64 million ounces from the July report. The increase in the short position by these banks total 7.81 million ounces of gold. With world production of gold at 75 million ounces, the increase represented approximately 11 percent of annual world production. On November 12, 2009, the BIS released its regular semi-annual OTC report on precious metals derivatives of the major banks and financial dealers in G10 and Switzerland ending June 30, 2009, covering the period January 1, 2009 through to June 30, 2009.

The release of the BIS report comes right after the violent activity on the COMEX from August through October, 2008. With respect to gold, according to the OCC, the total notional amount of gold derivatives in the USA actually fell from $107 billion to $99 billion, yet JP Morgan's position remained relative unchanged, falling from $82.5 billion worth of gold to $81.2 billion worth of gold.

As far as risk is concerned, JP Morgan has almost percent of the USA derivative risk. In the BIS report with respect to gold, the total gold derivatives attributed to the banks rose from $332 billion to $425 billion, which is made up of 179 billion of forwards or swaps and 246 billion of options.

In tonnage of gold, the increase in derivatives total 2,300 tons, wherein 1,800 tons of gold increase came by way of forwards and swaps, and 500 tons by way of options. Clearly, the derivatives substantially increased, and thus exposing the banking sector to great risk. With respect to silver, the BIS calculated that the total derivatives had peaked at an all time high of $203 billion USA. In ounces of silver, the total forwards in silver generate -- which generally is perceived as the total short absent any better data totaled 7.5 billion ounces. The increase in derivatives in silver totaled 2.8 billion ounces.

The increase alone represented four times the annual production of silver. The total short or forward position in silver, that is, the 7.5 billion ounces, represents over ten years of silver production.

To my knowledge, this level of concentration has never happened in any commodity. It is important to realize that the BIS only records risk to its bankers. Thus, if a bank is long in one jurisdiction and short in another, the BIS would cancel the two as there is no risk to the banks. However, despite the netting in gold and silver by the BIS, this central bank perceives considerable risk in the forwards on both silver and gold to the banks that they monitor. In silver, Ted Butler has calculated that the total short position in COMEX silver equates to approximately 500 million ounces, of which JP Morgan accounts for 200 million of those ounces.

CHAIRMAN GENSLER: If I could just ask, because we do have your written statement, just if you could --

MR. ORGAN: Okay. I'll finish now. I propose that all players -- in the turmoil of August, 2008, billions of dollars were lost by investors by the shorting action of the banks in question. Most commodities in the COMEX have position limits of approximately one to two percent of annual production. This has worked well over the years in gold and certainly in silver. These limits have been exceeded, and thus, we're witnessing manipulation on a daily basis on a rather large scale.

I urge the Commission to place position limits on the precious metals, and these limits must be placed whether it's on the long side or on the short side. I propose that all players wishing to hedge must deposit 40 percent of their short position in bullion in the COMEX warehouse and must sign an affidavit that the hedger has 100 percent of the title to that metal and undertakes not to encumber the title in any way while it serves as collateral to the short position. Furthermore, no derivative position should be eligible to serve as collateral for a hedge position. I thank you for your attention.

CHAIRMAN GENSLER: Thank you, Mr. Organ. And I just have to find, where do I look, but Mr. Christian is going to speak next.

MR. CHRISTIAN: Hopefully you can hear me, Mr. Chairman.

CHAIRMAN GENSLER: Absolutely, we can hear you fine.

MR. CHRISTIAN: Okay, great. There is a time delay on this, so we'll be a little bit awkward. My name is Jeffrey Christian and I run CPM Group. I've actually done commodities research in energies, as well as metals since the 1970's, the middle of 1970's. I ran the J. Aron Research Department, which became the Goldman Sachs Commodities Research Group. In 1986, I managed a management buyout of the Commodities Research Group from Goldman to set up CPM.

I have always been a strong advocate that the CFTC needed better regulations, clarified regulations and a strengthened posture for regulating the commodities markets. I've also been, since 1986, a strong advocate of some sort of regulatory oversight of over-the-counter derivatives markets. I'm a little bit concerned that some of the proposals I've heard recently don't sound like they would do any good in terms of real economic policy and regulatory goals in the OTC markets, but probably would be destructive of economic value in the U.S. investment banking market.

The subject today is position limits,

and I give you a little bit of my background, vis-`-vis, my views of the CFTC, just so that you don't misunderstand my position toward CFTC mandated and managed position limits.

My position is that CFTC managed position limits would do nothing to improve the efficiency, honesty, integrity or fairness of the metals commodities markets. Instead, I believe they would create a risk if they were ill conceived and ill applied of driving liquidity into the less regulated and less transparent markets overseas and over-the-counter.

It seems most appropriate to me that the Commission continue to rely on the exchanges to impose and manage position limits, as it has since 1975, albeit perhaps with greater CFTC input, oversight and advice. Now, there are good reasons for position limits to exist for non-commercial market participants. This may be even more true today than in the past given the rise of mechanically managed passive long only funds that will buy and hold commodities either in the futures market or in the case of precious metals ETF's with physical metal.

The structure of many of these funds pose some real risks that they could put a tremendous amount of money into the market buying and holding long positions, and then in some instances trying to liquidate unmanageably large positions, long positions in short periods of time.

However, I think a more thorough analysis of the situation may suggest that a broader regulatory approach to the rise of these funds is needed and that position limits alone probably would not suffice -- be sufficient to protect the markets and market participants from the risks that these long only passive index funds provide.

Viable alternative metals markets exist world- wide, people have said that over and over again. Regulatory arbitrage would take a moment to execute, and it would happen. In my 30 plus years of working with producers, processors, users, institutional investors and high net worth individuals, not only in precious metals and copper, but also in energy and other commodities, most of the activity I have seen these groups do have occurred in the OTC markets. That's important for a couple reasons, but it's also important -- the first reason I bring it up for right now is to understand how fast volumes and liquidity can transfer to the OTC markets.

Federally managed position limits I think would probably have the same effect on commodities as -- actually had on equities. It would drive a lot of liquidity off of U.S. regulated markets into private, less transparent, more opaque markets, and it would deprive the U.S. economy of significant revenue and stature in the international economy.

Any position limits would have to have exemptions for commercial participants, including commodities trading banks and brokers. I've been a little bit surprised at the extent to which people talking today at these hearings have not accepted the fact that banks are, in fact, bona fide hedgers. They are, and, in fact, they are the largest bona fide hedgers involved in exchange traded futures and options.

Many producers and industrial users of commodities do not trade directly on the futures market, but rather trade on the OTC market with their banks and dealers. Their trading counterparts in the OTC market then use the futures to hedge their resulting price exposure. I also think it would be ill advised for the CFTC to proceed with an idea which is to disallow trading companies to serve as swap dealers, hedgers and proprietary traders simultaneously.

Forcing diversified firms into this pseudo Salamanca decision as to which part of their baby they should choose to keep would severely damage market efficiency and intelligence.

Now, much of the intelligence accrues to these diversified trading entities, but the fact is that the entire market does learn from them and does benefit from their knowledge.

I also get concerned when I hear people say that they should be solonistic camazars deciding who is a legitimate speculator and who has legitimately side speculative position, and there should be someone who can determine who belongs in the markets and who doesn't.

CHAIRMAN GENSLER: Jeffrey --

MR. CHRISTIAN: Now, my written testimony is about six times larger than this. In conclusion, I think the CFTC should take a medical approach to the application of its authority. First and foremost, it should do no harm. Thank you.

CHAIRMAN GENSLER: I thank all the panelists, and I did promise Mr. Strait I'd ask about OTC, but I did -- I couldn't help but the invitation to Sorbanes-Oxley, some of you may know, I helped Senator Sorbanes, then Chairman of the Senate Banking Committee, on that bill. I think that that was a necessary regulation.

I think that we had calamitous results

in the accounting field by accounting firms in a sort of self- regulatory environment at that time, and the main function of that bill set up oversight that was not self-regulatory, but the public accounting oversight board, so we probably have a little bit different view on that, Mr. Christian and I.

And I don't think that there's been significant evidence that that bill itself sent issuers overseas. There were a lot of other things, a lot of other global issues going on, but since you just raised it, I decided to react. But, Mr. Strait, if I could just ask you about clearinghouses and what point you wanted to make on that.

MR. STRAIT: Yeah; first, I think that what Jeff brought up is something that should have been brought up a long time ago, and that is that the FCM, the model of an FCM is really inherently American, okay. People don't do business with FCM's in Europe directly, they go to their bank. It's almost like a prime brokerage relationship within the hedge fund world, if you will. And they supply everything, they supply the financing, they supply the look alike features products, okay. So to --

CHAIRMAN GENSLER: Can you do it short, because I do have another question?

MR. STRAIT: Yeah, I'm sorry. Okay. Just to say there is a big difference, and to segregate the books is not that easy. I do appreciate that, you know. It's not customer driven -- it's customer driven business and it's house driven, but it's pretty hard to segregate what that actually is since they're making markets their customers, okay.

Now, with regard to OTC clearing, the event of the financial meltdown of two years ago has been a great boom to the OTC cleared products, particularly I've watched ClearPort very closely because we're major counterparts and we do a lot of clearing at ClearPort Triland, and we've seen that business grow dramatically where, you know, the --

CHAIRMAN GENSLER: I'm going to apologize. I really have other questions. Just what's your point on the clearing?

MR. STRAIT: The point I'm trying to make is that that -- the CFTC and the industry in general and the FCM's in concert should be encouraging and standing by trying to bring in OTC clearing because it does -- it brings transparency and you can see what's going on in the price mechanism and so on.

The question I have is, if you're going to try to implement, if the CFTC is looking to implement OTC position limits, how is that going to impact the traffic of business going through ClearPort, and for that matter, I --

CHAIRMAN GENSLER: So if I understand it, and I think I deeply share your view, clearing helps lower risk --

MR. STRAIT: Absolutely.

CHAIRMAN GENSLER: -- to the financial system as a whole?

MR. STRAIT: Right.

CHAIRMAN GENSLER: We want to encourage that in any way, working with Congress and other ways to do that, you're just saying that we have to be cognizant, in your view, that position limits may have some counter veiling effect?

MR. STRAIT: Correct.

CHAIRMAN GENSLER: Is that -- okay. I think I got it. Mr. Masters, I have a quick question. I didn't quite understand, on gold and silver, the precious metals, were you saying that they are not consumable commodities, and thus, maybe have a different approach than position limits? I just wasn't sure I was following.

MR. MASTERS: Well, I was dividing position limits into two categories, you know, the consumable commodities category, you know, food, energy, copper in this case is consumable, versus precious metals, which would have a manipulative position limit set rather than an excessive speculation limit set, in other words, because it's -- I'm not considering it consumable because of its traditional role as a store --

CHAIRMAN GENSLER: I see; some panelists have said that to address manipulation, it's in the near month and the delivery function, and this broader role that we were given in the 1930's about excessive speculation is the all months combined, or at least that's how some have articulated; is that what you're suggesting, or is it --

MR. MASTERS: Well, I'm saying that in terms of the regime in the sense of the all months combined, that would be one way of looking at excessive speculation in terms of a regime of position limits to combat excessive speculation as differing from manipulation.

Additionally, what I was suggesting was that if you had two regimes, a whole notion of open interest in the market, where the market itself was deemed to be excessively speculative, more than 50 percent speculative open interest versus hedgers, for instance, then that could be brought back down to some more reasonable level than we've seen in the past.

CHAIRMAN GENSLER: I thank you. I have almost the red light, so Commissioner Dunn.

COMMISSIONER DUNN: Thank you, Mr. Chairman. Mr. Strait and Mr. Masters, you both say that if we do something or don't do something, it's going to result in bubble. Mr. Strait, you said if we don't have over-the- counter authority, that it's going into the opaque markets and we'll end up with a bubble. Mr. Masters, you say if we don't have position limits, we're going to end up with a bubble. Could you two kind of work that out a little bit amongst yourselves?

MR. STRAIT: May I share that with you? Okay. The answer is, yes, and what I think is being suggested here is that you're going to -- there's a discussion about application of position limits specifically to futures contracts, okay. What I'm saying is, what are you going to do about ClearPort, what are you going to do about the emerging and very necessary, in my view, OTC clearing mechanisms that the exchanges have put in place, which I think -- I think the market needs, and they shouldn't be jeopardized by some confusion with regard to position limits.

How can you have position limits in a product in the futures market when the same clearinghouse is clearing an OTC product without position limits? That's the question I have for the Commissioners and the Chairman.

MR. MASTERS: Yeah; I would just say that, you know, we've testified enumerable times that we need clearing. Clearing is a necessary systemic risk reducer for the markets. But with regard to position limits -- and until you really get clearing, it's hard to really have adequate position limits. And so when we've talked about this, we've always talked about the concept of aggregate position limits, which are position limits that go across markets that are done at the control entity level versus doing them on a market, a specific market level, because then you're discriminating against the CME or you're discriminating against OTC or whatever, so they need to be done, you know, across markets.

COMMISSIONER DUNN: Mr. Strait, you have talked about the Minneapolis exchange wheat contract and the difference between that and the metals contract, and there are actually three wheat contracts that we have, there's the Minneapolis Grain Exchange, the Chicago Board of Trade, which is -- sets the world price, and then there's Kansas City Board of Trade, all three of those are different types of wheat, and it's a high protein wheat in the Minneapolis Grain Exchange.

And in March of 2008, when those prices went up, every time the price went up, price limit went up, and there was an offering, Japan tendered an offer, and the real problem there was catching up with the cash price with the futures price.

And in those agricultural markets, we also have price limits that have an impact in those situations. People say that position limits may not have worked in the agricultural market, I would submit that at that particular time, the fundamentals were such, the supply and demand were such that it was driving at market and not speculation or anything of that nature, although I think there were a lot of speculative money that went in there as a hedge against -- or a flight to safety, I guess, because it was the same time we were beginning to see a meltdown in the capital market.

My question to you is, because you said this in the fact that this current contract on silver is something that not everybody is going to view like Mr. Epstein did and go out and buy it. Would -- is there a need for another type of silver market out there? Should an exchange look at coming up with a different type of a mini contract or something?

MR. STRAIT: Commissioner Dunn, I believe that the silver market is largely an OTC market anyway. It's a market that's traded over-the-counter and traded in London, and if you're trading overnight in Japan and you're trading in Hong Kong or you're trading in Russia or anywhere else, you're doing basis good London trading, you're not trading COMEX, right. So to say that we need another market, probably not, I don't think there's another need for a futures market in silver. I don't think there's enough volume to go around right now. So the answer is, no, I don't believe there should be another market.

COMMISSIONER DUNN: So it's not a contract problem, per se?

MR. STRAIT: No, it's not a contract, it's the nature of the commodity. We're talking about your wheat products are all different, and you're obviously very familiar with that. Silver is different than gold, and platinum and -- are different than silver and gold, which is another thing I want to bring up regarding the jurisdiction of ETF's. How anybody let a platinum plated ETF happen is beyond my comprehension, but it did. Somehow it slipped past, God must have been sleeping when it happened, but I'd like to discuss that at some point, as well.

CHAIRMAN GENSLER: Thank you,

Commissioner Dunn. Commissioner Sommers.

COMMISSIONER SOMMERS: Thank you, Mr. Chairman. I actually don't have any questions. I'd be glad to let you discuss your concerns with the --

MR. STRAIT: All right, thank you, I appreciate that, Commissioner. Platinum/platium are strategic metals, and going back to the idea that all metals are different, as all agricultural commodities are also different, some are global and some are not. Platinum/platinum are strategic metals. Platinum group metals in general are strategic metals. During the height of the Cold War, we could import all we wanted from the Soviet Union without a duty, because it was deemed as a strategic metal, as chromium was, a nickel was, okay.

To take a very complex group of metals, platinum/platinum, rhodium, ruthenium and iridium and take them and put them into an ETF so that the inventory ends up stocking an investor product, in my view, is insane. I have no other word to describe it. You can not officially drive the prices up, and you're going to have -- theoretically put these very, very important metals to our industry or space, tech, military and so on and so forth, in the hands of people who can trade them over their, you know, their E trade account, securities account.

The question I have is, CFTC and the exchanges and the trade and supervision over the years by exchanges has been superlative and I think that the record shows that it has generally done very well and the CFTC's oversight has been wonderful. Exchanges have done a good job regulating their own markets. And, you know, I trade platinum and platium, and I've been through kind of the struggles with, you know, low warehouse stocks at NYMEX, and that's the only real futures market in the world apart from a small one in Japan, Tocom. What's going to happen when this economy recovers and people are going to need this stuff again and it's sitting in an ETF some place? What's going to be the price impact of that?

More importantly, why does the SEC have jurisdiction over this when it should be CFTC jurisdiction? That's my question. And the more this happens, the more those questions are going to arise. Because industry, in general, should be very concerned about the ETF's and certain strategic products, and these are two that are. Thank you.

COMMISSIONER SOMMERS: Thank you for that answer. I think that as we have discussed the issues of position limits, not just in the metals complex, but in the other areas where ETF's are also prevalent, they raise a lot of really unique questions, and I'm hopeful that as we work through these issues, that there will be -- some of these concerns addressed with these kind of unique players in the market.

CHAIRMAN GENSLER: Thank you, Commissioner Sommers. Commissioner Chilton.

COMMISSIONER CHILTON: Well, Mr. Strait talked about, you know, these markets aren't

Walmart, and Commissioner Dunn started to get in this, too, and, you know, it's exactly right, which is why in 2008, when we had high demand, high retail price, and low futures price, where people actually went in and bought the stuff, like Walmart, they went and bought the stuff, and so that gave a number of us, you know, a concern that maybe this is something we needed to address, just like Mr. Epstein went and bought the stuff.

And Mr. Christian, I appreciate his testimony. He had a lot of ills in his testimony. If we have ill conceived position limits and ill applied position limits, well, duh, of course, they wouldn't work if we ever ill conceived, I mean that's why we're having this hearing, we're trying to figure it out.

But he did add something that I forgot when I talked about all the wicked, scary things that could happen with these position limits, he added communist, so I want to make sure I put that in the list of things. But I appreciate that we're trying to get down to the nub of this and try to fix it. So, Mr. Masters, let me go to you and say, how would you apply these limits, would you come up with them individual, by individual contract, and should they be -- should there be any exemptions to these things? I have some sympathy for what Mr. Norrish said about banks need to be able to take on large risk, what's your view about how you would come up with these levels and about any exemptions to those levels?

MR. MASTERS: Thanks, Commissioner. Well, a couple things, just to get the banks out of the way real quick. So banks are hedgers for commercial participants in some ways, so they wear a hat to do that, but in addition, they also have propped us, and they speculate themselves, so in one notion they're a hedger, in another notion, they're a speculator.

I think that that needs to be separated, clearly. They need -- if they're a speculator, they need to have the rules applied to them that every other speculator are applied to. If they're doing a hedge transaction for a hedger, that's another thing, and certainly that can be done and the technology exists to do that.

With regard to position limits, you know, again, consumable commodities are different. And Rich was talking about platinum, some of these base metals, that's another consumable commodity. Whenever you get consumable commodities involved, then you've got a problem. Food, energy, anything that people actually have to use to consume, you have an issue, and that's why you need position limits against excessive speculation.

So, you know, in my opinion, the easy way to solve it is, you greatly reduce the impact of passives. You could literally, you know, have a very severe --

COMMISSIONER CHILTON: You're talking in the aggregate, Mr. Masters?

MR. MASTERS: In the aggregate, that's right.

COMMISSIONER CHILTON: So speculators, what I've called the massive passives as a group, as a type of speculator, you would say not more than such and such percentage, and would you have individual limits, as well, and then in the aggregate?

MR. MASTERS: I think you could do both. I think for --

COMMISSIONER CHILTON: And how does that work? So say all of us are passive -- massive passives and we've got whatever, 30 percent of the market or 40 percent of the market, well, all of a sudden Doug Leslie wants to be a massive passive, too, what happens, do we reduce all of our positions a little bit, or is Doug not allowed to be part of this, how would that work? I haven't been able to figure it out myself, to be honest with you. I like the concept.

MR. MASTERS: I think passive -- first of all, the difference between passives and regulator speculators needs to be clear, and that is, passives consume liquidity, traditional speculators don't. So we want traditional speculators, and the more passives you have, the less traditional speculators you can have with regard to the role of position limits.

So if I was running things, I would eliminate all the passives, I would say zero, because I don't think they contribute any --

COMMISSIONER CHILTON: Well, let me ask you just a little bit about them. Sorry for interrupting, my time is about to go. So, you know, I have this concern about ETF's, as well, but to some extent, and this may be what Commissioner Sommers was getting at, I mean it is a way for individuals, retail folks to be investing in these markets, you know, what about that, is there another mechanism, I mean are you concerned about that, or is this not a place for those individuals to begin with?

MR. MASTERS: I don't think it's a place for them to begin with for a lot of different reasons. I mean if you ask the average individual to explain what a contango is and how that effects this ETF in consumable commodities, for instance, the fact that the USO, when it came out in 2006, was $65, and today it's $39, and it's supposed to track the price of crude, you know, 99 percent of them could answer that, so --

COMMISSIONER CHILTON: It's tracking, it's just a year ago December.

MR. MASTERS: Right, exactly. I mean it's, you know, all that is storage yield, and they don't -- that's not well understood. So there's a lot easier ways of tracking inflation. The tips, if you want to make the bet against the dollar, the currency markets are the most liquid thing in the world, go by the euro, go by the yen, it's easy. They're a lot more liquid, and then there's no issues with you interloping on hedgers.

CHAIRMAN GENSLER: Commissioner Chilton, we're going to have another round, so Commissioner O'Malia.

COMMISSIONER O'MALIA: First of all, if we're going to put on position limits, we need to put one on Mr. Masters' testimony, I think it's 55 pages or something like that.

MR. MASTERS: Appendices.

COMMISSIONER O'MALIA: Okay, they don't

count. Let me build on what Commissioner Chilton has said in the struggle to kind of how are you going to reign in this class of investor. And you've written extensively, and you're well known for your comments and views on oil markets and energy markets, where the U.S. is really the dominant market, and what we struggled with here today, and some of the charts you may have seen earlier, the U.S. is not the dominant market in metals.

And if we are going to put position limits on and concentration limits, whatever we're going to do, how do we make that stick, and how do we address some of the concerns you've raised in this market, in this metals market with the global nature? And I invite anybody to comment on that, as well.

MR. MASTERS: I would just say that you're exactly right. I mean, you know, clearly, I mean the LME is the dominant market, and you don't have jurisdiction there, so it makes it a much different conversation. And again, you know, just going back to the testimony, the only really market that you have much control over here is this copper market, and with the COMEX, and I think you could do what you can on the COMEX, personally, you know, I think the FSA should do a lot more. We're going to meet with them on this issue. So I hope that we can influence them from that standpoint, because they're the dominant market.

COMMISSIONER O'MALIA: I've got another question, and this one is for Mr. Christian. I assume he can follow along here. But both Mr. Organ and Mr. Epstein on the second panel raised the concerns that short position exceed the physical supply. The second panel kind of argued that that wasn't a concern. Are you concerned that the shorts will not be able to deliver if called upon?

MR. CHRISTIAN: No, I'm not at all concerned. For one thing, it's been persistently that way for decades. Another thing is that there are any number of mechanisms allowing for cash settlements and problems. And the third thing is, as many people who are actually knowledgeable about the silver market and the gold market have testified today, almost all of those short positions are, in fact, hedges, the short futures positions are hedgers offsetting long positions in the OTC market. So I don't really see a concern there.

COMMISSIONER O'MALIA: Mr. Organ, would you like to respond?

MR. ORGAN: I do see a risk on this, and I think it's a risk that we have to be very careful of. As countries like China, and South Korea, Russia start demanding and taking physical delivery of their gold and moving it offshore to their shores and putting pressures on our -- on the COMEX, and we will probably come to a point in time where we will have a failure to deliver.

MR. DOUGLAS: Can I make a comment?

CHAIRMAN GENSLER: No; who are you? Okay. I don't -- no, I said no. I don't know who -- who is this?

MR. DOUGLAS: I'm Adrian Douglas, I'm assisting Harvey.

CHAIRMAN GENSLER: All right, yes.

MR. DOUGLAS: Is my microphone on?

CHAIRMAN GENSLER: Yes.

MR. DOUGLAS: I'd just like to make a comment about we're -- we're talking about the futures market hedging the physical market, but if you look at the physical market, the LBMA, it trades 20 million ounces of gold per day on a net basis, which is $22 billion, that's $5.4 trillion a year, that's half the size of the U.S. Economy, if you take the gross amount, it's about one-half times the U.S. economy. That is not trading 100 percent metal, it's a fractional reserve basis. And you can tell that from the LBMA's web site, because they trade unallocated accounts. And if you look at their definition of unallocated account, they say you're an unsecured creditor.

Well, if it's unallocated, if you buy 100 tons of gold, even if you don't have the serial numbers, you should have 100 tons of gold, so how can you be an unsecured creditor? Well, it's because it's fractional reserve accounting. I mean you can't trade that much gold, it doesn't exist in the world.

So the people who are hedging these positions at LBMA are essentially, it's paper hedging paper. And Bob Chilton uses the expression, stop the pandemonium, you know, this is Pozi scheme. Because gold is a unique commodity, and people have mentioned this, that it's left in the vault, it's not consumed, that means that most people trust the bullion banks to hold their gold, and they trade it on a ledger entry. So one of the issues we've got to address here is the size of the LBMA and the OTC markets which are supposedly backing these positions which are hedging, but it's backing paper.

CHAIRMAN GENSLER: I guess I get time. I don't have any other questions. Commissioner Dunn.

COMMISSIONER DUNN: Thank you, Mr. Chairman. Mr. Christian, I appreciate the difficulty of trying to do this by remote, but at the end of your testimony, you began talking about bona fide hedge exemptions for commercial traders must be part of position limits and not to grant hedge exemptions to swap dealers would be devastating to exchanges, liquidity and price discovery capacity and got into who determines what is legitimate or not. Could you amplify on that a bit and what you see is the danger there?

MR. CHRISTIAN: I could definitely amplify on it. Amplifying on it a bit is a little bit more difficult because it's a very big subject. The first thing is, precious metals, copper, other metals, energies, they're all traded internationally, and these are fungible commodities by and large. I mean there's been a lot of strange things that have been misspoken about the, you know, the difference between the retail market and the wholesale market, and we don't have time to really go over those, I don't think, but the fact of the matter is, excuse me, I'm in a building that has motion sensitive lights and it doesn't recognize what I do as human activity.

CHAIRMAN GENSLER: Those were your words, not anybody here.

MR. CHRISTIAN: Yeah; no, actually they were my wife's. If you start putting position limits on bona fide hedgers, for example, bullion banks, and the previous fellow was talking about hedges of paper on paper, and that's exactly right. Precious metals are financial assets, and like currencies and T bills and T bonds, they trade in the multiples of 100 times the underlying physical, and when people buy and sell those, they are voting and they're giving an economic view of the world or a view of the economic world as they see it.

And when you start saying to a bank, okay, I have a number of people, you know, actually, let's go back to a concrete example of Mr. Organ. He was talking about August of 2008, when there was an explosion of the short positions in gold and silver held by bullion banks on the futures market, and he seemed to imply that that was somehow driving the price down. If you understand how those bullion banks run their books, the reason they had an explosion of their short position was because they were selling gold and silver hand over fist in the forward market, in the physical market, and in the OTC option market. Everyone in the world was buying physical gold everywhere in the world. The bullion bankers and standard market makers were selling or making commitments to sell them material, and they had to hedge themselves, and they were using the futures markets to do that.

If you put position limits on the futures markets, they will have to find some other mechanism to hedge themselves, and they will.

COMMISSIONER DUNN: Jeffrey.

MR. CHRISTIAN: Someone will provide that market because it's a big world out there.

COMMISSIONER DUNN: Jeffrey, I'm going to have to cut you off because I want to ask one other question of Mr. Organ.

MR. CHRISTIAN: Go ahead.

COMMISSIONER DUNN: All right, I'm sorry. Mr. Organ, in your testimony, you really posed a whole series of questions in saying, how do you conclude that such large and increase in short positions in gold could not be manipulative, and it kind of brings us full circle back to the first panel we had on -- and which were asking to define excessive speculation, that which causes unreasonable functions or unwarranted changes in price. And you're turning that question around saying how could we not find that when what we're charged with is how do we do find that, and could you tell us how we do find it rather than how we -- how could we not find it?

MR. ORGAN: Well, I'm very concerned that the size of one bank, one or two banks, and how they're manipulating prices, and how on any particular day, like yesterday they would just whack, and they're controlling the price, and my understanding is that the COMEX should be a price discovery mechanism, and all of a sudden this large bank or two are making sure that -- they are determining the price. And as Chairman Gensler says, that we should be a price discovery mechanism, and we're seeing the opposite, and that's what I'm trying to do -- relay in my remarks, that I would certainly like this to be a price discovery system and not having one or two gorillas, as some of the commentators have said, dictate the price.

CHAIRMAN GENSLER: Thank you, Commissioner Dunn. Commissioner Sommers. Commissioner Chilton.

COMMISSIONER CHILTON: One more; this issue of regulatory arbitrage, and I think you can -- there are valid arguments on both sides, I get it, I'm willing to acknowledge that you could have it, particularly if you retched down the limits so much. If they were, as Mr. Christian says, ill advised, ill conceived, et cetera, but not in my talking points, and that's where we're headed.

I do think that anything -- any nations that sort of sought to have a less regulated status, that it would be short lived, short sided, and that if we put an appropriate position limit mechanism in place, one that acknowledges the concerns about going to the OTC market or going overseas, that we could actually be, for lack of a better term, the gold standard for regulation, and that that would built confidence in these markets.

Along that line, I wonder, Mr. Organ, if you think that, without implementing position limits, that there is some risk of markets leaving the U.S. And I appreciate this as a Canadian that you're saying it, but would you tell us what you think?

MR. ORGAN: Well, first of all, the position limits are important, but it's not only that, but it's the huge exemptions that are given that has to be addressed. As a Canadian, of course, we have one large bullion bank, Bank of Nova Scotia, which owns Macotta, but I feel that if we have the position limits similar to let's say one or two percent of annual production, it should hold well, it's held well for all these years, and then we look at the exemptions that we give and make sure that the exemptions to these bona fide hedgers is verifiable, that they put, if they are hedging, that they put in a 30 percent -- 40 percent of physical metal in COMEX, and it's verifiable, and then it should work well. And we should, at that point, should stop the manipulation, and I think we would have fair and free markets.

COMMISSIONER CHILTON: Thank you. Mr. Masters, can I get your take on this, you know, migration of markets to OTC or foreign nations if we implement position limits?

MR. MASTERS: I would just say that I think most fiduciaries today, and this is 2010, versus let's say two years ago, and people made the same argument, want more regulation, not less. They're going to regimes where there's more transparency and more, you know, the whole notion of too big to fail I think has been brought down. I think people, you know, the threat that, you know, we're all going to go to Hong Kong or we're going to go to Dubois or somewhere to trade all these things, it's an empty threat, it's just not going to happen. You're not going to see folks go overseas, large fiduciaries, because, you know, what happens if we have another crisis, you know, will the government of Dubois stand behind those trades, you know, what's the counterparty? The whole notion for clearing, the whole reason fiduciaries, many fiduciaries now support clearing is because they want to take the credit component of their trade and separate that from the directional bet that they'd like to make, or the directional hedge.

So I think it's really an empty threat. I think getting over the counter trades onto the same paradigm that listed trades are, with the notion of position limits that go across, you get a system where you have -- you don't have arbitrage between those two places, but you have a system where credit no longer is an issue for fiduciaries, and I think that's probably their number one concern now when, you know, making trades.

COMMISSIONER CHILTON: Thank you, Mr. Chairman.

CHAIRMAN GENSLER: I did want to follow-up on Commissioner Dunn's question for Mr. Christian, if I might, because I didn't quite follow your answer on the bullion banks. You said the bullion banks had large shorts to hedge themselves selling elsewhere, and I didn't understand. I might just not have followed it, and you're closer to the metals markets, you've been doing this, but how do you short something to cover a sale? I didn't quite follow that.

MR. CHRISTIAN: Actually, I misspoke. Basically what you were seeing in August of 2008 was the liquidation of leveraged precious metals positions from a number of places, and the bullion banks were coming back to buy it, and they were hedging those positions by shorting -- by going short on the COMEX, and that's really what it was.

CHAIRMAN GENSLER: All right. So I'm glad I asked, because I didn't follow that. But if I think of the earlier charts that our head of the Division of the Market Oversight, Mr. Sherrod, had, these concentrated shorts have been, you know, reasonably consistent. They're not exactly the same one every day, but his chart showed a sort of similarity across a couple of years. So what -- I mean I'm just trying to understand, what are bullion banks hedging on the other side? We heard from the other panelists, but you seem to be familiar. What are they -- I mean is it -- is it warehouse receipts, is it -- what is it?

MR. CHRISTIAN: No, it's a tremendous number of things. You were at Goldman I think shortly after me. We had a MIS system that kicked out -- bullion --

CHAIRMAN GENSLER: That's really remarkable because we don't seem to have a lot of similar views, but, you know, a lot of people were at Goldman Sachs.

MR. CHRISTIAN: Well, I didn't like the trends at Goldman, so I left in '86. But, you know, honestly, and bad jokes aside, if you look at a bullion bank's book, it's gold book, for example, you will see an enormous number of things. There will be gold forward purchases from mining companies, there will be forward purchases from refineries, there will be gold that's been leased out to electronics manufacturers and component manufacturers and catalyst manufactures and jewelers.

As gold flows through the beneficiation process, and again, you know, these are all long, complex issues that are hard to reduce, you know, a lot of producers will sell their gold the moment it leaves their position -- their possession at the mine, and it might be in concentrate form or it might be in -- form. It then goes to a smelter or a refiner. The bullion bank buys that. It agrees to a price at the time it's buying that, but it won't be allowed to sell that metal until it has refinery outturn, which may be two weeks, but it could be six months. So they will go into the market and short the market in order to cover the commitment they've made to buy at that price.

And then when they get the metal in the physical market, they can either sell that metal and unwind the hedge in the short position on the futures or in the forward market or do something else.

There are all sorts of other derivative contracts that investment banks and bullion banks will sell to investors, to other banks, pension funds, to insurance companies, and each of those often time will have a long exposure in gold, which will be hedged with offsetting shore position.

So if you looked at a bullion bank's gold book or a silver book, you would find a large range of topics. One of the things that the people who criticized the bullion banks and talk about this undue large positions don't understand is the nature of the long positions in the physical market, and we don't help it. The CFTC, when it did its most recent report on silver, used the term which we use in the market, the physical market, and we use that term, as did the CFTC in that report, to talk about the OTC market, forwards, OTC options, physical metal and everything else. And people will say, well, there is, and you've heard it today, there is not that much physical metal out there, there isn't. But in the physical market, as the market uses that term, there is much more metal than that, there's 100 times what there is.

If I look at the large short positions of the COMEX silver contract, my question is, where are the other shorts being hedged, because the short position that I believe bullion banks use to hedge their physicals is larger than their short position on the COMEX, and the answer is, they hedge it in the OTC market in London.

CHAIRMAN GENSLER: I thank you for that detailed discussion. And I thank all of our panelists for their expert testimony and their patience with us. And I think with that, unless there's other things for the Commission, this meeting is adjourned.

Wait, do I have to have -- this comment period on this meeting is open until April 30th, this record, I should say, it's not a comment period, the record of this meeting. There is a comment period on our position, energy position moments that's open until April 26th, and we invite the public to comment or send records in, that would be terrific. Thank you.

(Whereupon, at 2:44 p.m., the PROCEEDINGS were adjourned.)

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CERTIFICATE OF NOTARY PUBLIC

I, Carleton J. Anderson, III do hereby certify that the forgoing electronic file when originally transmitted was reduced to text at my direction; that said transcript is a true record of the proceedings therein referenced; that I am neither counsel for, related to, nor employed by any of the parties to the action in which these proceedings were taken; and, furthermore, that I am neither a relative or employee of any attorney or counsel employed by the parties hereto, nor financially or otherwise interested in the outcome of this action.

/s/Carleton J. Anderson, III

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Case Name: ____

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Please note any errors and the corrections thereof, on this errata sheet. Any change or correction should have a reason. It may be a general reason, such as "To correct stenographic error," or "To clarify the record," or "To conform with the facts." Once you have completed the sheet, signed and dated it, return the sheet to your attorney, not to the court reporting agency. Attorneys should exchange errata sheets among the parties.