Public Statements & Remarks

Statement of Dissent of Commissioner Rostin Behnam Regarding Position Limits for Derivatives

October 15, 2020

Introduction

The last time we gathered as a Commission to discuss position limits I used some of my time to speak a bit about the award winning movie, *Ford v Ferrari*.[1] At that point, we were nearing the airing of the 92nd Academy Awards and this action-packed drama had earned four nominations—not to mention the distinction of being one of the few films I actually saw in a theater. For those of you who have not found it in one of your quarantine movie queues, *Ford v Ferrari* tells the true story of American car designer Carroll Shelby and British-born driver Ken Miles who built a race car for Ford Motor Company—the GT40—and competed with Enzo Ferrari's dominating, iconic red racing cars at the 1966 24 Hours of Le Mans.[2] I used the film and racing metaphors throughout my speaking and written statements to highlight serious concerns that the proposed amendments to the CFTC rules addressing position limits (the Proposal) signified yet one more instance where the Commission seemed to be comfortable with deferring core, congressionally mandated duties to others and calling it a victory.[3]

We are here today to finalize the Proposal.[4] In just short of nine months, we have come to terms with life during a global pandemic complete with economic turmoil and pockets of historic market volatility. Amid the mere 60-day open comment period following the Proposal's publication in the Federal Register (graciously extended by 16 days to May 15th in light of the pandemic[5]), on April 20th, the price of the West Texas Intermediate crude oil futures contract (WTI contract), a key benchmark in the energy and financial markets, experienced an unprecedented collapse one day prior to the last day of trading and expiration for May delivery.[6] Defying market mechanics, the price of the contract fell from $17.73 per barrel at market open, to a closing settlement price of negative $37.63—with the price dropping approximately $40 in the last 20 minutes of trading.[7] And, while we are still in recovery, with great fanfare after almost 10 years, the Commission is going to establish the position limits regime required under the Dodd-Frank Act. I am reminded again of Ken who, at the 1966 24 Hours of Le Mans, went against his gut, giving way and leaving behind a milestone in car racing that to this day remains elusive.

If you have not seen the movie, this is a spoiler alert: Ken did not win Le Mans in '66. While he was one and a half laps ahead of two other GT40s, he was given orders to slow down so that the three Fords in the lead would cross the finish line in a dead heat formation. Ken lost his well-deserved win because the 24 Hours of Le Mans awards the victory to the car that covers the greatest distance in 24 hours. In the event of a tie, the rules provided that the car that had started farther down the grid had traveled the greater distance. Ken's GT 40 had started in the grid roughly 60 feet ahead of the GT40 driven by Bruce McLaren and Chris Amon, who were the declared winners. [8]

In the film, Ken seems to accept his loss with quiet dignity. However, in reality he was fully aware that in many respects, he had been robbed. From what I've read, Ken likely articulated his feelings a bit more colorfully. [9]

The point is that bringing something across the finish line doesn't always equate to a success. As detailed in my questions today, I believe that by going against our Congressional mandate and clear statutory intent by overly deferring to the exchanges, we have relinquished a claim to victory in this final position limits rule which in many ways has itself felt like the CFTC's version of the 24 hours of Le Mans. Therefore, I will go with my gut and not be part of the formation in supporting this final rule.

A Long Road, But a Fast Finish

It has been nine years since the Commission first set out to establish the position limits regime required by amendments to section 4a of the Commodity Exchange Act (the Act or CEA)[10] under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.[11] While today's final rule purports to respect Congressional intent and the purpose and language of CEA section 4a, in reality, it pushes the bounds of reasonable interpretation by overly deferring to the exchanges[12] and allowing them to take the lead in administering a position limits regime.

In passing the Dodd-Frank Act, Congress understood that for the derivatives markets in physical commodities to perform optimally, there needed to be limits on the amount of control exerted by a single person (or persons acting in agreement). In fact, Congress has understood this need since at least 1936, when it first authorized the Commission's predecessor to impose limits on speculative positions in order to prevent the harms caused by excessive speculation. In tasking the Commission with establishing limits and the framework around their operation, Congress was aware of our relationship with the exchanges, but nevertheless opted for our experience and our expertise to meet the policy objectives of the Act.

Last January, as the Commission voted on the Proposal that is being finalized today, I warned that we seemed to be pushing to go faster and just get to the finish line, making real-time adjustments without regard to even trying for that "perfect lap."[13] Just nine months later, nothing has changed. If anything, we seem to be further prioritizing just crossing the finish line over achieving a rule that actually follows Congressional intent and its first order priority: protecting market participants from excessive speculation.

Letting the Exchanges Make the Call

As I argued in regard to the proposal, my principal disagreement is with the Commission's determination to in effect disregard the tenets supporting the statutorily created parallel federal and exchange-set position limit regime, and take a back seat when it comes to administration and oversight.[14] Like Ken Miles, the Commission is relinquishing a rightful lead in an act of deference. In doing so, the Commission claims victory for recognizing that the exchanges are better positioned in terms of resources, information, knowledge, and agility, and therefore ought to take the wheel. While this may seem like the logical move, it ignores that even if we operate as a team, our incentives and interests are not fully aligned. Based on consideration of the Commission's mission, and Congressional intent as evinced in the Dodd-Frank Act amendments to CEA section 4a and elsewhere in the Act, I continue to believe that (1) the Commission is required to establish position limits based on its reasoned and expert judgment within the parameters of the Act; (2) the Commission has not provided a rational basis for its determination *not* to establish federal limits outside of the spot month for referenced contracts based on commodities other than the nine legacy agricultural commodities; and (3) the Commission's seemingly unlimited flexibility in deciding to (a) significantly broaden the bona fide hedging definition, (b) codify an expanded list of self-effectuating enumerated bona fide hedges, and (c) provide for exchange recognition of non-enumerated bona fide hedge exemptions with respect to federal limits, is both inexplicably complicated to parse and inconsistent with Congressional intent.

Not only does the final version of the rule fail to address these deficiencies in the proposal, it actually goes and makes many of these issues worse.

Ignoring a Mandate

Like the proposal, this final rule goes to great lengths to reconcile whether CEA section 4a(a)(2)(A) requires the Commission to make an antecedent necessity finding before establishing any position limit,[15] with the implication that if a necessity finding is required, then the Commission could rationalize imposing no limits at all. Looking back at the record, what is necessary is that the Commission complies with the mandate in the Dodd-Frank Act.[16] In the 2011 Proposal, the Commission provided a review of CEA section 4a(a)—interpreting the various provisions, giving effect to each paragraph, acknowledging the Commission's own informational and experiential limitations regarding the swaps markets at that time, and focusing on the Commission's primary mission of fostering fair, open and efficient functioning of the commodity derivatives markets.[17] Of note, "Critical to fulfilling this statutory mandate," the Commission pronounced, "is protecting market users and the public from undue burdens that may result from 'excessive speculation.'"[18] Federal position limits, as predetermined by Congress, are most certainly the only means towards addressing the burdens of excessive speculation when such limits must address a "proliferation of economically equivalent instruments trading in multiple trading venues."[19] Exchange-set position limits or accountability levels simply cannot meet the mandate.

In exercising its authority, the Commission may evaluate whether exchange-set position limits, accountability provisions, or other tools for contracts listed on such exchanges are currently in place to protect against manipulation, congestion, and price distortions.[20] Such an evaluation—while permissible—is just one factor for consideration. The existence of exchange-set limits or accountability levels, on their own, can neither predetermine deference nor be justified absent substantial consideration. As I argued in my dissenting statement regarding the Proposal, the authority and jurisdiction of individual exchanges are necessarily different than that of the Commission. They do not always have congruent interests to the Commission in monitoring instruments that do not trade on or subject to the rules of their particular platform or the market participants that trade them. They do not have the attendant authority to determine key issues such as whether a swap performs or affects a significant price discovery function, or what instruments fit into the universe of economically equivalent swaps. They are not permitted to define bona fide hedging transactions or grant exemptions for purposes of federal position limits. It is therefore clear that CEA section 4a, as amended by the Dodd-Frank Act "warrants extension of Commission-set position limits beyond agricultural products to metals and energy commodities."[21]

"If it ain't broke, don't fix it"

In spite of all of this—the foregoing mandate; the clear Congressional intent in CEA section 4a(a)(3)(A); and the Commission's real experience and expertise (including its unique data repository)—the Commission's final rule only maintains federal non-spot month limits for the nine legacy agricultural contracts (with questionably appropriate modifications), "because the Commission has observed no reason to eliminate them."[22] Essentially, the Commission concludes: "if it ain't broke, don't fix it." In keeping with this relatively riskless course of action, the Commission similarly concludes that federal non-spot month limits are not necessary for the remaining 16 proposed core referenced futures contracts identified in the Final Rule.

In so doing, the Commission ignores Congressional intent. The Commission never considers that Congress directed the Commission to establish limits—not accountability levels. The Commission's observation that exchange-set accountability levels have "functioned as-intended" until this point in time ignores the wider purpose and function of aggregate position limits established by the Commission, and is shortsighted given the ever expanding universe of economically equivalent instruments trading across multiple trading venues. As I pointed out in my dissenting statement regarding the Proposal, it seems odd to conclude that Congress envisioned that its painstaking amendments to CEA section 4a were a directive for the Commission to check the box that the current system is working perfectly.

Hedging on Bona Fide Hedging

Today's Final Rule provides for significantly broader bona fide hedging opportunities that will be largely self-effectuating, and the Commission defers to the exchanges in recognizing non-enumerated bona fide hedging. While I support enhancing the cooperation between the Commission and the exchanges, the Commission here is cooperating by dropping back. The Commission's decision to essentially give up primary authority to recognize non-enumerated bona fide hedges seems both careless and inconsistent with Congressional intent.

I raised these concerns last January when we voted on the Position Limits Proposal. Unfortunately, rather than retaking the lead, the Commission further cedes authority to the exchanges. The Proposal provided the Commission with the authority to reject an exchange's grant of non-enumerated bona fide hedge recognition, and provided a window of ten business days (or two in the case of sudden or unforeseen circumstances) for the Commission to make this determination. I pointed out in my dissent that this did not give the Commission nearly enough time or guidance to properly make a determination. In today's Final Rule, the Commission actually further reduces its ability to make an independent determination. Now, market participants will be able to establish positions based upon an exchange's non-enumerated bona fide hedge recognition during the Commission's 10-day review period, and the Commission cannot determine that the person holding the position has committed a position limits violation during the Commission's ongoing review or upon issuing its determination. This reduces the Commission's review to an ineffectual afterthought.

Trust the Process

A clear theme in my statements regarding our many rules over the last few years is this: process matters. Sharing our viewpoints with the public matters. Following the Administrative Procedure Act,[23] and giving the public an opportunity for meaningful comment on our proposals, matters. We are at our best when we involve all five Commissioners and our many stakeholders in the process.

I want to thank the Chairman for consistently providing the Commissioners with drafts of proposed and final rules 30 days in advance of an open meeting. I believe there have only been two major exceptions over the course of our many laps in the last year: the position limits proposal, and the position limits final rule. In the case of the final rule, we did not receive a full draft until last Friday–six days before the open meeting. This simply is not enough time for the Commission to engage in a fulsome discussion of the merits of the rule, and makes the final rule more or less a fait accompli. Perhaps most perplexing is that we did not receive a draft of the cost benefit considerations until two weeks ago. This is literally a rule where a prior iteration resulted in a court challenge–one that the Commission lost.[24] If ever a rule required more consideration by the Commission itself, this would seem to be it. Instead, the Commissioners actually had less time to review and consider the rule than we normally do.

When we focus on just getting to the finish line, and do not take the time for meaningful consideration and dialogue, we risk failing to take into account everything that we should in our rulemakings. Subsequent to the issuance of the Position Limits Proposal, there was a major market event resulting from the ongoing pandemic that may have important implications for our position limits regime. As the NYMEX Light Sweet Crude Oil (CL) contract, also known as the WTI contract, neared expiration in April 2020, the contract experienced extreme volatility, with the market trading below zero for the first time. The Commission received at least eight comments that addressed this event; a number of commenters noted that the extreme volatility was driven by speculators. The speculators, unable to physically deliver upon expiration for various reasons, had no choice but to exit the contract at whatever price was available. Commission staff continues to review and analyze this event, and the rule today recognizes that the analysis may impact the rule itself. Today's preamble states: "The Commission will continue to analyze the events of April 20 to evaluate whether any changes to the position limits regulations may be warranted in light of the circumstances surrounding the volatility in the WTI contract."[25] This begs the question–if the Commission is currently in the midst of this analysis, why not wait to finalize position limits until the analysis is complete?

Conclusion

Before concluding, I want to acknowledge and thank the Commission staff who worked on the Proposal, today's final rule, and every related study, matter, and undertaking to support it for the better part of 10 years. You were the design team, the engineers, the production team and the pit crew. You kept us on course at a pace set by our Chairman, and you have performed at the top of your field.

Back in '66, by holding back, Ken Miles lost the win at Le Mans, which denied him the "Triple Crown" of endurance racing: the 24 Hours of Daytona, the 12 Hours of Sebring, and the 24 Hours of Le Mans. No driver has won all three races in the same year, [26] and Ken missed out because he was part of a team and Ford had been good to him. [27] He committed and moved forward without the victory that should have been his because he was the best driver that day. I am committed to vote and move forward, even if it means giving up the triple crown of the day. But I will not go against my gut.

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[1] Statement of Dissent by Commissioner Rostin Behnam Regarding Position Limits for Derivatives; Proposed Rule, https://www.cftc.gov/PressRoom/SpeechesTestimony/behnamstatement013020 (the Dissent).

[2] Ford v Ferrari, Fox Movies, https://www.foxmovies.com/movies/ford-v-ferrari (Last visited Oct. 13, 2020).

[3] Dissent.

[4] *See* Position Limits for Derivatives, 85 FR 11596 (Feb. 27, 2020).

[5] *See* Press Release Number 8146-20, CFTC, CFTC Extends Certain Comment Periods in Response to COVID-19 (Apr. 10, 2020), https://www.cftc.gov/PressRoom/PressReleases/8146-20; Extension of Currently Open Comment Periods for Rulemakings in Response to the COVID-19 Pandemic, 85 FR 22690, 22691 (Apr. 23, 2020).

[6] *See* Statement of Commissioner Dan M. Berkovitz on Recent Trading in the WTI Futures Contract before the Energy and Environmental Markets Advisory Committee Meeting (May 7, 2020), https://www.cftc.gov/PressRoom/SpeechesTestimony/berkovitzstatement050720 .

[7] *See* Bloomberg News, *The 20 Minutes that Broke the U.S. Oil Market,* Bloomberg (Apr. 25, 2020), https://www.bloomberg.com/news/articles/2020-04-25/the-20-minutes-that-broke-the-u-s-oil-market?sref=DzeLiNol.

[8] Press Release, Ford Division News Bureau, For Immediate Release at 8 (July 5, 1966), made available in PDF at Wikipedia, the Free Encyclopedia, 1966 24 Hours of Le Mans, at https://en.wikipedia.org/wiki/1966_24_Hours_of_Le_Mans.

[9] Matthew Phelan, *What's Fact and What's Fiction in Ford v. Ferrari*, SLATE (Nov. 18, 2019), https://slate.com/culture/2019/11/ford-v-ferrari-fact-vs-fiction-le-mans-ken-miles.html.

[10] *See* Position Limits for Derivatives, 76 FR 4752 (proposed Jan. 26, 2011) (the 2011 Proposal).

[11] The Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203 § 737, 124 Stat. 1376, 1722-25 (2010) (the Dodd-Frank Act).

[12] Unless otherwise indicated, the use of the term "exchanges" throughout this statement refers to designated contract markets (DCMs) and swap execution facilities (SEFs).

[13] Dissent.

[14] *Id.*

[15] *See* Final Rule at III.

[16] The Commission's analysis in support of its denial of a mandate misconstrues form over substance and assumes the answer it is looking for. The Commission seems to suggest that it is free to ignore a Congressional mandate if it determines that Congress is wrong about the underlying policy. *See* Final Rule at III.A.

[17] 76 FR at 4752-54.

[18] *Id.* at 4753.

[19] *Id.* at 4754-55.

[20] *See* 76 FR at 4755.

[21] *Id.*

[22] Final Rule at II.B.2.i.

[23] 5 U.S.C. 553(b).

[24] *Int'l Swaps & Derivatives Ass'n v. U.S. Commodity Futures Trading Comm'n*, 887 F. Supp. 2d 259 (D.D.C. 2012).

[25] Final Rule at I.G.

[26] Martin Raffauf, *Porsche and the Triple Crown of endurance racing*, PORSCHE ROAD & RACE (Dec. 7, 2018), https://www.porscheroadandrace.com/porsche-and-the-triple-crown-of-endurance-racing/.

[27] Phelan, *supra* note 9.

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