07-29-09

CFTC Chair Gensler: set position limits for all non-commercials

By Jon H. Harsch

In the second day of three Commodity Futures Trading Commission (CFTC) hearings on whether the CFTC should set "federal position limits for commodities of finite supply" to curb possible "excessive speculation in the energy markets," CFTC Chair Gary Gensler listed progress made during the first hearing: "The Chicago Mercantile Exchange made a very significant announcement that it supports adoption of a hard limit regime, including single-month and all-months limits."

At the second hearing on July 29th, Gensler said it is "very encouraging" that several witnesses during the first two hearings supported his position that "it should be the CFTC that sets position limits on energy market participants" because "We have the statutory authority, and we are the most able to strike a balance between competing interests and the public interest." He said broad agreement on setting position limits leads to the next question: exemptions from limits. With a broad grin, he noted that "the swap dealers believe that swap dealers should be exempted, the exchange traded funds believe that exchange traded funds should be exempted, and the index funds believe that the index funds should be exempted."

Gensler left no doubt about his own views, explaining that "At the core of promoting market integrity is ensuring markets do not become too concentrated. I think this is even more relevant because of the development in financial markets which have become more concentrated since the first exemptions were allowed in 1991." He said that "The financial crisis highlighted the risk to the market and to the American public brought about by large concentrated actors on the financial stage." Suggesting position limits should be applied consistently to all non-commercial players, Gensler concluded that "While I believe that we should maintain exemptions for bona fide commercial hedgers, I am concerned that granting exemptions for financial risk management can defeat the effectiveness of position limits."

Indicating the direction he's headed – and recognizing the fact that the Obama administration, the House and the Senate are hard at work on financial regulatory reform legislation – Gensler said the CFTC should "work with Congress to establish new authorities to police over the over-the-counter markets."

CFTC Commissioner Bart Chilton explained why the CFTC, Congress and the administration all see the need for change: “futures markets have changed. They are no longer dominated by commercial hedgers, like utilities, refiners, and airlines, but rather, are flush with new, non-traditional participants, such as pension funds, university endowments, hedge funds and index portfolios. This new asset class of investors views the energy complex of commodities not as a hedge against energy costs, but as an investment to protect against long-term inflation and a way to diversify portfolios. . . This represents a tectonic plate shift in futures market operation, and raises some obvious questions as to whether rules that have been in place for decades now need to be reviewed in light of new market conditions.”

Chilton concluded that “In addition to quick administrative action to review issues related to position limits and hedge exemptions, I’m looking forward to prompt Congressional action to provide CFTC with the needed authorities to effectively oversee dark markets, including the ability to require reporting, recordkeeping, clearing as appropriate, as well as necessary enforcement authorities to protect against fraud and manipulation. These are specific areas in which we can improve our regulatory oversight, and provide a real benefit to the American taxpayer and to the economy.”

At CFTC hearing on position limits and hedge exemptions July 29, L to R: Commissioner Jill Sommers, staff member, Chair Gary Gensler, two staff members, Commissioner Michael Dunn, staff member, Commissioner Bart Chilton. Photo: *Agri-Pulse*.

Commissioner Jill Sommers sounded less ready for action, warning that “The issues surrounding position limits and hedge exemptions are enormously complex. Every market has its own characteristics so what works for the soybean markets, for example, may not be appropriate for natural gas markets.” Calling for more data collection and “input from all sides of the marketplace,” she said the CFTC needs to consider questions such as “Should hard position limits be imposed in all physical commodities and if so, should they be imposed on exchange trading without similar limits in place for OTC markets?” She warned that making inappropriate changes could “have the perverse effect of driving large portions of the market away from centralized trading and clearing at the very same time we are urging all standardized OTC activity to be traded on-exchange or cleared. Likewise, I am concerned that, without global standards, trading will move to other financial centers around the world.”

Another warning came from Dr. Henry Jarecki, Chairman of Gresham Investment Management. He testified at the July 29th hearing that he's "naturally fearful that our business will be throttled in the false understanding that commodity futures index purchases can cause prices to rise." Swimming against the apparent CFTC tide, he rejected the theory that market speculators are responsible for driving up commodity prices. But he forecast that the CFTC will act because "the idea that commodity futures purchasers cause high physical market prices is superficially appealing. And I accept that the Commission may, in response to public concern, decide that something should be done."

Goldman, Sachs Managing Director Donald Casturo acknowledged that "Increases in volatility and the outright prices of energy commodities have caused concerns to be raised at the CFTC and among policymakers about changes in the marketplace and regulatory practices. Some have questioned the role played in the marketplace by index investors, other financial participants and intermediaries such as my firm that are commonly referred to as 'swap dealers.' These questions have prompted the CFTC to hold these hearings to obtain input on three particularly important areas of regulation: namely, position limits, swap dealer hedge exemptions and transparency."

In response to such concerns, Casturo said that "the role that is played by non-traditional participants such as index investors and other financial participants often has been mischaracterized" and that the CFTC should avoid imposing new rules that "not only will fail to address the perceived harms but also will have unintended consequences that may be disruptive to liquidity and the markets generally." He warned specifically that "eliminating or limiting swap dealer hedge exemptions will impair liquidity."

Casturo maintained that speculators have benefited the marketplace in two ways:

- "First, increased participation by financial investors, both in commodity indexes and in single commodity products, has brought new capital to the markets that has facilitated the ability of commercial market participants to hedge their price exposures."
- "Second, swap dealers have largely replaced the floor traders as the predominant source of liquidity to buyers and sellers in the commodities markets and in so doing have provided more customized forms of risk management products to end-users."

To read testimony from the July 28th and July 29th hearings or watch webcasts of the two hearings, go to: http://cftc.gov. The third hearing will be held Aug. 5th at the CFTC in Washington, DC.

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