08-05-09

CFTC Chair Gensler favors 'consistently applied' position limits

By Jon H. Harsch

In the third and final day of Commodity Futures Trading Commission (CFTC) hearings on futures market volatility, the two sides squared off. Market participants who blame "excessive speculation" said it is "common sense" to blame unregulated speculation when oil prices shoot up – as they have – at a time of ample supply and low demand. From the opposite corner, U.S. Commodity Funds Chief Investment Officer John Hyland said his huge oil and natural gas index funds in fact have reduced volatility and that critics citing "common sense" do so only because they lack data to support their claims.

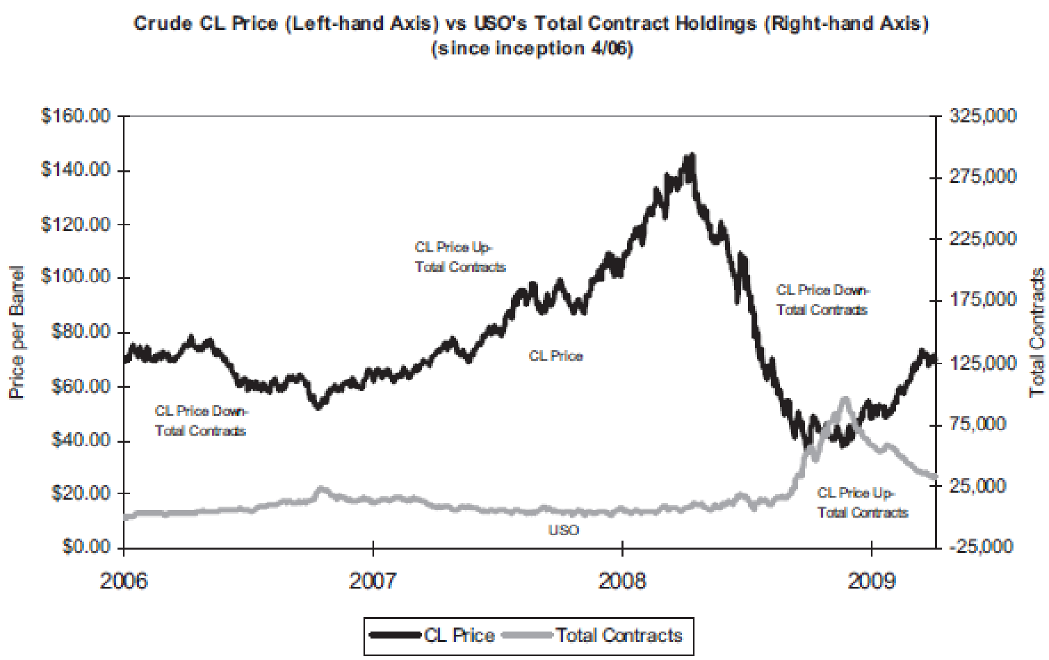
CFTC Chair Gary Gensler repeatedly asked the day's nine witnesses to try to identify "common ground." The only common ground shared by the opposing camps was that the CFTC faces tough choices about what to do next – and that if the CFTC decides to step up its monitoring and enforcement activities, it will need Congress to give the already overstretched federal watchdog agency more money, manpower and authority.

Paul Cicio, president of the Industrial Energy Consumers of America, a trade association representing manufacturing companies with over $900 billion in annual revenues, charged that "Excessive speculation in the natural gas market is real and must be stopped immediately. . . We believe that excessive speculation is a reality that must be addressed through aggregated position limits, limiting speculative transaction exemptions and increased oversight. . . From January to August of 2008 the price of natural gas more than doubled because of excessive speculation, not supply and demand fundamentals. During the same time period, U.S. production of natural gas rose about 8 percent, national inventories were well within the 5 year average and demand was essentially unchanged from the same period of the previous year. As a result of excessive speculation, consumers paid over $40 billion in higher natural gas costs."

Cicio concluded that "The creation of the futures market was not intended to be a substitute for a gambling casino for Wall Street banks, hedge funds, sovereign funds and index funds."

Prof. Philip Verleger, center, back to camera, explains his charts showing market volatility driven by supply & demand, not speculators, in Commodity Futures Trading Commission hearing August 5th on "Speculative Position Limits in Energy Futures Markets." Photo: *Agri-Pulse*.

Hyland countered by charting the positions held by one of his firm's major funds, the United States Oil Fund (USO). He explained that as was the case with last year's spike in crude oil prices, "the most recent increase in crude oil prices, which began in February of 2009 and continues to the present, coincides with a period in which USO was once again a large scale seller of futures contracts, not a buyer. During the most recent run-up in prices, USO has steadily sold off 65% of its peak level holdings."



Source: United States Oil Fund, LP

Faced with sharply conflicting testimony from market participants, Gensler concluded at the third hearing that the CFTC "should seriously consider setting position limits in the energy markets," adding that the CFTC is likely to propose new rules this fall.

Gensler gave three reasons for setting energy market position limits:

- "First, it is our statute. In 1936, the Congress said that the CFTC 'shall' impose limits on trading and positions as necessary to eliminate, diminish, or prevent the undue burdens that may come as a result of excessive speculation. We are directed by statute to act in this regard to protect the American public."
- "Second, while we currently set and enforce position limits on certain agriculture products, we do not for energy markets. I believe that position limits should be consistently applied across markets for physical commodities of finite supply. . . A lot has changed since the early 1990s when the assumption was that because energy markets were larger, they were different. To the contrary, I believe that the size of the markets and the effects that they have on the day-to-day lives of the American public make it that much more important that we aggressively fulfill our mandate."
- "Third, I believe that at the core of promoting market integrity is ensuring markets do not become too concentrated. This is even more relevant today because financial markets have become more concentrated since the first exemptions were allowed in 1991 and the position accountability level regime was first implemented. The financial crisis highlighted the risk to the market and to the American public brought about by large concentrated actors on the financial stage."

Challenging Hyland's view that the rapidly increasing size of his firm's index funds increases market liquidity and stability, Gensler asked "At what point of market concentration does a trader detract from liquidity instead of enhance it?" Answering his own question, he stated that "Position limits should enhance liquidity by promoting more market participants rather than having one party that has so much concentration so as to decrease liquidity."

To watch a webcast of the August 5th CFTC hearing on "Speculative Position Limits in Energy Futures Markets," or read written testimony prepared for the hearing, go to: http://cftc.gov/newsroom/cftcevents/2009/oeaevent080509.html

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