



# CFTC unveils oil and gas limits; deemed light touch

Thu, Jan 14 2010

By Ayesha Rascoe and Tom Doggett

WASHINGTON (Reuters) - The top U.S. futures market regulator unveiled its long-awaited proposal to crack down on speculation in oil and gas markets on Thursday, setting position limits so high that they would affect only a handful of the most massive players, to the relief of edgy traders.

In an effort to prevent excessive concentration in energy trading, the Commodity Futures Trading Commission issued proposals to cap the number of contracts a company can hold across exchanges. The limits were less stringent than expected and offered limited exemptions for swaps dealers who hedge financial exposure, such as Goldman Sachs.

"It seems to me as though the CFTC has really pulled back," said John Brodman, a former Energy Department official with the Bush administration.

"A few months ago, they sounded rabid about going after speculators in energy markets. But it looks like their bark was worse than their bite," Brodman said.

For instance, the limit on crude oil would equate to a 98 million barrel position -- equal to more than a day's global consumption, or near \$8 billion at current prices. This is five times the New York Mercantile Exchange's own loosely enforced cap, which may assuage fears that tough limits would cause an exodus of liquidity to overseas or unregulated markets.

However, as part of the Obama administration's push to overhaul financial markets, the CFTC must explain its softer approach to lawmakers who have clamored for regulatory action since oil prices surged to a record \$147 a barrel in 2008.

Independent Vermont Senator Bernie Sanders, a high profile voice on the left in Congress who is on a number of committees including Energy, was first to slam the plan.

"We need to stop Wall Street from jacking up oil prices and we need to do it now," he said.

He said consumers should not have to wait until March 2011 for the limits to take effect. The CFTC itself did not provide a timetable.

The limits will apply to futures and options contracts of light, sweet crude oil, RBOB gasoline, No. 2 heating oil and Henry Hub natural gas futures traded on both the NYMEX, owned by the CME, and the IntercontinentalExchange.

Oil and natural gas prices were little changed after the news, as were shares in CME and ICE.

"It seems to be somewhat benign, in line with what we were expecting," said Chris Allan, analyst covering exchanges at broker-dealer Pali Capital.

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Graphic on CFTC path to reform: [here](#)

Proposal: [r.reuters.com/qyh63h](http://r.reuters.com/qyh63h)

Proposed rule making Q&A: [r.reuters.com/ryh63h](http://r.reuters.com/ryh63h)

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Giving it the official go-ahead to launch the proposals for the required broader input period, the CFTC commissioners voted 4 to 1 to seek comment on the limits over the next 90 days.

"We believe it's a measured and balanced approach but we want to hear from the public," CFTC Chairman Gary Gensler told CNBC after the meeting.

Jill Sommers, the commissioner who voted against issuing the proposed rule, said she was concerned the CFTC's "piecemeal" action was "unwise," and said the proposal should have addressed passive long index traders.

In brief, the limit for the entire commodity would be set annually based on open interest at the sum of 10 percent of the first 25,000 contracts plus 2.5 percent of the remaining interest, allowing a regular annual adjustment to the limits rather than the fixed caps the CFTC applies to grain markets.

It said the limits, if implemented, would affect the 10 biggest position holders in all markets. Over the past two years, only 3 "unique owners" in the crude oil market and only one in the natural gas market would have been affected, according to Steve Sherrod, Acting Director of Surveillance at the CFTC.

"I think that first we're going to err on the high side. We don't want to do any damage," Chilton said in a video interview with Reuters Insider ahead of the CFTC releasing its proposal.

The exchanges themselves will continue to allow exemptions for bona fide end-users, companies who need to hedge their physical positions, while the CFTC will be responsible for granting "risk management" exemptions to swap dealers at a maximum of two times the otherwise applicable position limit.

But it said that such players, the likes of Goldman and Morgan Stanley, would not be allowed to take on speculative positions that would exceed the exemptions, limiting their ability to make additional bets with their own money if they are already offsetting customers' positions.

#### OPEN QUESTIONS

But it said the limits should help prevent out-sized players from becoming a risk to the whole market.

For example, the CFTC said under the limits, the giant hedge fund Amaranth would not have been able to hold the large number of natural gas contracts it did in 2006, which led to the fund's collapse with ripples felt across markets.

"Certainly, some of those with size to move the market around will find it difficult to operate as usual," said Chris Jarvis, senior analyst with Caprock Risk Management.

But they were far from strenuous compared to existing exchange-set "accountability limits", which for NYMEX crude is 20,000 contracts across all months -- one-fifth the CFTC's.

And investors had questions about how the CFTC might get a grip on the vast over-the-counter energy markets and what it would do about the influx of passive, long-term investors who buy and hold positions via index funds.

"The fact that we have a whole class of traders that only buys and holds what they don't need distorts the market and needs to be addressed," said Peter Beutel, president of Cameron Hanover.

It appeared likely to be just the start, as the CFTC said it would seek public comments on how to address the passive long investors who typically buy and hold contracts via commodity indices, and whether metals, coffee, sugar and cocoa should also be subject to similar position limits. It will hold a meeting in March to focus on silver and gold markets.

#### CFTC CHAIRMAN PROMISED TO GET TOUGH

The proposal is the first major regulatory reform for the CFTC since Gensler, a former Goldman Sachs executive, became chairman in May with promises to get tough on the volatile world of commodity trading.

His actions parallel reforms pending in Congress and dovetails with the Obama administration's proposals to bring over-the-counter derivatives under federal regulation.

Efforts to tighten positions limits have drawn their fair share of critics. The ICE and the Chicago Mercantile Exchange, the world's largest exchange which owns the NYMEX, have urged the CFTC to be cautious.

Opponents say limits could actually make markets more volatile, distort pricing functions and push traders to less-regulated offshore markets.

The UK's Financial Services Authority recently issued its own plan for overhauling OTC markets, which sharply contrasted with European Union and U.S. plans. The FSA said while it supported preventing manipulation, position limits were not the most effective way to curb manipulation and volatile prices.

Commodity traders have been bracing for tougher trading limits since the CFTC announced in July it was going to review limits.

Several large exchange-traded funds have been forced to suspend share issuance or adjust their strategies to appease regulators, while some major players are working out ways to shift toward trading of physical commodities.

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