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CFTC Poised to Cap Speculation in Energy With Senate Backing
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By Asjylyn Loder

May 21 (Bloomberg) -- The top U.S. commodity regulator is poised to impose new rules on oil speculators as Congress and the European Commission attempt to rein in trading in the $615 trillion over-the-counter derivatives market.

A bill by Senate Democrats to overhaul financial regulation would require the Commodity Futures Trading Commission to set limits on the number of contracts a single trader can hold in commodities such as crude oil, natural gas, heating oil and gasoline, including the bilateral contracts known as swaps that are negotiated outside of regulated exchanges.

The Senate approved the measure yesterday and it now must be reconciled with a version voted by the House last year. The legislation dovetails with the commission's January proposal to cap contracts on regulated exchanges, and would extend the agency's authority to the over-the-counter market for the first time since swaps trading began nearly 30 years ago.

"The chances that position limits will pass now are stronger than they were in January," said Michael Greenberger, a former CFTC director of trading and markets and now a professor at the University of Maryland School of Law. "If they are waiting for a signal from Congress as to what the scope of their power will be long term, this is a pretty powerful signal."

The commission's proposal was a response to concerns that speculators contributed to oil prices rising to a record $147.27 a barrel in 2008. Commissioner Michael Dunn, a Democrat who may be a swing vote on the limits, has said he opposed capping trading on exchanges only to push traders into the opaque over- the-counter market.

## Setting Limits

Legislation introduced by Democratic Senators Christopher Dodd of Connecticut and Blanche Lincoln of Arkansas gives the commission oversight of that market, and says the commission "shall" set position limits. A Republican amendment, which said the commission "may" set caps, failed on May 12.

The commission proposal hinges on gaining control of the over-the-counter market and taking steps to prevent traders from sidestepping regulation by taking their business abroad, said Gary Dewaal, general counsel for Paris-based Newedge Group. The legislation addresses at least part of Dunn's concerns, and strengthens the odds that the proposal will get at least three votes from the five-member commission, he said.

"It certainly moves them in that direction," Dewaal said. "Whether it's a slam dunk, I don't know."

The vote may ultimately break down along party lines, Greenberger said. Statements made during the January hearing indicate that the proposal has support from Chairman Gary Gensler and Commissioner Bart Chilton, both Democrats. Scott O'Malia, a Republican and a new member, expressed the same reservations as Dunn. Jill Sommers, also a Republican, cast the sole vote against putting the proposal out for comment.

## Dunn's Vote

"I thought that it alleviated a lot of the concerns people have expressed to me in the derivatives area," Dunn said in an interview when asked about the legislation. He declined to say whether the bill tipped his vote in favor of position limits.

"I want to make sure that we're able to see the entire spectrum and I still have concerns about us harmonizing regulation internationally," Dunn said. Without consistent international rules, traders could simply move to less regulated countries, he said.

One measure in the Senate bill allows the CFTC to regulate and set position limits on contracts traded on foreign boards of trade that allow access to U.S.-based traders.

Gensler has also pushed foreign regulators to adopt similar rules. In the last three months, he has traveled to Tokyo, Brussels and London touting the need for greater safeguards in derivatives trading, arguing for tighter limits on hedge funds and swaps dealers, and consistent international rules.

## European Action

Position limits are under consideration in Europe. Last month, Christine Lagarde, the French finance minister, said the European Union should create a commodity market watchdog similar to the CFTC, and that the Group of 20 nations should standardize "the principle of position limits" to prevent manipulation and reduce market risk.

The European Commission said in October that it would introduce in 2010 "ambitious legislation to regulate derivatives," including giving regulators the ability to set position limits.

The rules may require over-the-counter transactions to be processed, or cleared, through a third-party clearinghouse. The proposal is due out in July, Michel Barnier, the European Union's financial services commissioner, said at a May 17 briefing in Brussels. If passed, the proposal would be binding on all 27 member states of the EU, including Germany, France and the U.K.

## CFTC Oversight

The over-the-counter derivatives market has escaped the CFTC's reach since the first interest-rate swap was traded in 1981. The transactions fell outside a law requiring that all futures be traded on regulated exchanges.

Three decades later, the U.S. over-the-counter derivatives market has grown to $300 trillion and remains unregulated, Gensler said in an April 12 speech at Columbia University in New York. The lack of regulation allowed institutions to build up enormous risk that ultimately threatened the U.S. financial system, he said.

If approved by the CFTC, the limits would apply to physically settled and cash-settled futures in light, sweet crude oil, Henry Hub natural gas, and New York Harbor gasoline and No. 2 heating oil. The contracts are traded on the New York Mercantile Exchange and the Intercontinental Exchange Inc. in Atlanta.

## Swaps Impact

Swaps dealers would no longer receive confidential hedge exemptions that allow them to exceed position limits, and instead would need “limited risk management exemptions” that would be reviewed monthly by the commission and made public after six months, the commission said.

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