Position Limits

CFTC Energy and Environmental Markets Advisory Committee Meeting, July 29, 2015

Managed Funds Association

Introduction

MFA represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry's contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, the Americas, Australia and many other regions where MFA members are market participants.

Introduction

MFA Members:

- Are active participants in the derivatives markets and rely on fair, competitive, transparent and liquid markets;
- Play a vital role in the markets by assuming price risk from commercial participants on the long and short sides of the market, reduce market volatility; and
- Provide liquidity that facilitates price discovery and risk transfer for businesses around the world.

MFA members perform an essential function in the energy markets, as the above activities benefit hedgers, and all consumers and producers of energy.

CFTC Position Limits Proposal

Rulemaking on position limits should be empirically driven and not a response to popular sentiment or partial analyses.

- In general, MFA has been concerned that the CFTC has not made an adequate finding with respect to the necessity of imposing position limits.
- Nevertheless, if the CFTC determines to proceed with implementing position limits, **MFA recommends that the CFTC obtain and use more accurate and complete data to establish limits, and that it adopt position limits/position accountability measures through a two-phase rulemaking approach.**

A Two-Phase Rulemaking Approach

MFA Recommendation: **The CFTC Should Adopt Position Limits/Position Accountability Measures Through a Two-Phase Rulemaking Approach.**

Phase One:

1. Adopt spot-month position limits.
2. Adopt definition for a *bona fide* hedging transaction.
3. Rely on and review data from DCM position accountability levels for non-spot months.

Phase Two:

1. Adopt position accountability levels for non-spot months based upon data gathered during Phase One.

Benefits of a Two-Phase Approach

Benefits of a Two-Phase Rulemaking Approach:

- Provides the CFTC with more time to gather accurate and reliable data.
- Minimizes unintended consequences, decreases the risk of market disruption and affords the Commission better data on which to base non-spot month position accountability levels/position limits.
- Provides market participants with time to comply with a comprehensive position limits regime encompassing a large number of contracts.

Benefits of a Two-Phase Approach

Concern: **The CFTC's proposed limits are based upon incomplete data.**

- Position limits should be based upon accurate and up-to-date data on deliverable supply and open interest, and take into consideration OTC contracts.
- The CFTC won't have accurate data on the breakdown of hedging and speculative trading until it finalizes and implements what constitutes a *bona fide* hedging transaction.
- Setting non-spot limits prematurely based upon incomplete data could reduce liquidity, cause bid-offer spreads to widen, increase transaction costs, and harm the ability of commercial market participants to use the futures markets to hedge risk.

Benefits of a Two-Phase Approach

***Concern:* The proposed position limits are miscalibrated and have been set too low.**

- Table 11a appears to indicate that markets are functioning with a high level of legitimate activity near, at or above the proposed position limit levels.
- The proposed position limits will likely restrict current legitimate activity.
- The CFTC has not made a finding that there is excessive speculation at the position limit levels it has proposed.

Benefits of a Two-Phase Approach

***Concern:* The open interest traits for the agricultural and energy markets are different. The CFTC should continue to analyze market differences and data before imposing non-spot limits.**

- Different levels of open interest for agricultural and energy markets establish a meaningful distinction between these markets. All-months-combined position limits in energy contracts could severely constrain liquidity in longer-dated contracts as open interest in energy markets may extend out for several months to years.
  - The majority of open interest for agricultural commodities is front-loaded in the first two or three contract months.
  - In contrast, for many energy contracts, open interest extends out for several contract months and years. *E.g.*, open interest in ICE's Henry Hub contract extends out to at least 70 months.

Benefits of a Two-Phase Approach

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- All-months-combined position limits in energy contracts could severely constrain liquidity in longer-dated contracts, especially if:
  - The limits are set in the same manner as for agricultural contracts; and
  - It is the same entities providing speculative liquidity in the longer-dated contracts as in short-dated contracts.
- Relying on and analyzing data from DCM position accountability levels during phase one will allow the CFTC to gather more data on the energy markets, including market traits and data on OTC positions, and to obtain deeper insight into market dynamics through dialogue with market participants as they become near or exceed a position accountability threshold.