Commodity Futures Trading Commission
CFTC's Energy and Environmental Markets Advisory Committee
Three Lafayette Centre
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Washington, DC
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February 26, 2015

Meeting Questions for EEMAC Consideration

Panel I: What does the data show?

The first panel will consider the remarks of Administrator Sieminski and discuss current conditions in U.S. energy markets, including factors leading to – and the effects of – the current drop in energy prices. The panel will examine Commission, exchange and third-party research and data – already part of the rulemaking record, as well as other research and data of which panelists and committee members are aware – to consider the impact of the Commission's proposed position limits regime[1] on U.S. energy markets. Discussion and debate will follow the panel presentations.

Panelists are:

- Vince McGonagle, Director, Division of Market Oversight;
- Steve Sherrod, Senior Economist, Division of Market Oversight;
- Tom LaSala, Chief Regulatory Officer, CME Group;
- Erik Haas, Director - Market Regulation, ICE Futures U.S.; and
- Craig Pirrong, Professor of Finance and Energy Markets, Director for the Global Energy Management Institute, Bauer College of Business, University of Houston

Key issues this panel will discuss:

1. Is excessive speculation that leads to sudden and unreasonable price changes present in U.S. energy markets? In particular, the panel will focus on energy prices in the last 10-15 years and examine whether these prices have reflected underlying supply and demand.
2. Does available research and data suggest the presence (or absence) of excessive speculation in these markets?
3. Assuming excessive speculation is present, does available research or data indicate that speculative position limits would effectively diminish, eliminate or prevent such excessive speculation?
4. What impact would a position limits regime, like the one the Commission has proposed, have on the U.S. energy market, as it trades today? The panel will consider whether position limits would have altered trading during the recent decline in energy prices.

Panel II: Exchange experience with position limits and trading liquidity.

Commenters have raised concerns that several aspects of the Commission's proposal may have an adverse effect on liquidity. This panel will consider the experience of U.S. exchanges in balancing trading liquidity with position limits. Representatives from major exchanges will describe their liquidity observations in energy derivatives. They will also share their experience administering position limits, particularly non-spot month limits, position accountability levels, and risk management exemptions, as well as discuss how these attributes of position limits impact liquidity. Discussion and debate will follow the panel presentations.

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[1] *See Position Limits for Derivatives*, 78 Fed. Reg. 75680 (Dec. 12, 2013); *Aggregation of Positions*, 78 Fed Reg. 68946 (Nov. 15, 2013).

Panelists are:

- Tom LaSala, Chief Regulatory Officer, CME Group; and
- Erik Haas, Director - Market Regulation, ICE Futures U.S.

Key issues this panel will discuss:

1. Are any major energy derivatives currently subject to the Commission's proposed 10-2.5 formula for calculating non-spot month position limits outlined in proposed rule 150.5?
2. If not, how are non-spot month positions managed or controlled to avoid manipulation, disruption and excessive speculation, which is required pursuant to DCM Core Principles 3, 4, and 5? *See* Commodity Exchange Act (CEA) sections 5(d)(3), (4), (5).
3. Do available data or studies indicate that concentration of positions outside the spot month has resulted in significant manipulation, disruption, and/or sudden and unreasonable price movements associated with excessive speculation?
4. Would the Commission's proposed 10-2.5 formula for non-spot month limits likely reduce liquidity outside the spot month in most energy markets?
5. Would a different non-spot month formula make sense for any energy derivatives? If so, which ones?
6. Did the so-called "futurization" of previously OTC swaps change the liquidity profile of energy derivatives?
7. Do the Commission's proposed position limit levels adequately account for the "futurization" of previously OTC energy swaps? If not, how should the position limits levels be adjusted to reflect "futurization?"
8. Could position accountability diminish, eliminate or prevent excessive speculation?
9. DCM Core Principle 5, section 5(d)(5) of the CEA, reaffirms exchange authority to set position accountability levels. If accountability levels are desirable, should the Commission consider permitting exchanges to administer such levels for derivatives subject to the position limits proposal?
10. Does the Commission have the legal authority to impose and/or administer *federal* position accountability levels outside of the spot month as appropriate limits under CEA section 4a(a)(3)? If so, would a federal position accountability regime be desirable outside of the spot month?
11. Are there any other factors the Commission should consider in permitting position accountability levels outside of the spot month?
12. Should the Commission consider updating estimates of deliverable supply to increase liquidity in the spot month?
13. Is such an update more needed for some commodities than others? Is it relevant that an exchange would have the ability to set its spot month limits *lower* than 25% of updated deliverable supply, if the exchange believes doing so is appropriate?
14. What other issues should the Commission consider to ensure sufficient liquidity for hedgers?

Panel III: Bona fide hedging.

This panel will focus on the challenges, if any, market participants in the energy markets would face the proposed position limits rules and bona fide hedging exemptions. Vince McGonagle and Steve Sherrod from the Commission's Division of Market Oversight will provide an overview of the Commission's bona fide hedging policy. Joe Nicosia, representing the Commodity Markets Council, and Ron Oppenheimer, representing the Commercial Energy Working Group, will outline some of the challenges the Commission's proposed hedging regime would pose for energy markets. Discussion and debate will follow the panel presentations.

Panelists are:

- Vince McGonagle, Director, Division of Market Oversight;
- Steve Sherrod, Senior Economist, Division of Market Oversight;
- Joe Nicosia, Commodity Markets Council; and
- Ron Oppenheimer, Commercial Energy Working Group

Key issues this panel will discuss:

1. Will the proposal's treatment of the bona fide hedge exemption distort efficient commercial decision making?
2. Is hedging an art or a science?
3. How perfect must a hedge be to have value in commercial risk mitigation?
4. The Commission has proposed to replace its current definition of "bona fide hedging transactions or positions"

in Rule 1.3(z) with a new definition of a "bona fide hedging position" in proposed rule 150.1. But the proposal does not provide for non-enumerated hedges that are available in current Rule 1.3(z)(3). See 78 Fed. Reg. at 75706. What sorts of non-enumerated hedges are currently used in U.S. energy markets? Should the Commission make such non-enumerated hedges available in its final rule? How would the availability of non-enumerated hedges impact U.S. energy markets?

5. Are the Commission's proposed enumerated hedges, defined in proposed rule 150.1, and illustrated with non-exclusive examples in proposed Appendix C to part 150, appropriate? Should the Commission add others? Are there risk-mitigation transactions or strategies currently used in U.S. energy markets that would not meet the proposed definition of an enumerated hedge?
6. Does the Commission's proposed interpretation of the phrase "economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise," CEA section 4a(c)(2)(A)(ii), pose special challenges for energy firms? Would this interpretation result in less efficient (or more costly) risk management?
7. Does the Commission's proposed interpretation of CEA section 4a(c) and its definition of enumerated hedges in part 150.1 jeopardize important protocols or transactions in the energy industry? Are there readily available substitutes? Are these substitutes, if any, equally efficient? Would end-users, and ultimately the American public, have to pay higher prices as a result? Should the Commission consider a different interpretation and/or implementation of section 4a(c)?
8. In addition, how could the Commission exercise its exemptive authority under CEA section 4a(a)(7) to permit continuing use of common transactions and/or protocols currently used in U.S. energy markets? Would requiring (1) hedge reports on Form 204, which are filed under penalty of perjury, and/or (2) contemporaneous documentation generated for business purposes provide sufficient assurance that market participants will not abuse hedge exemptions?
9. Cross-commodity hedges: Why are cross-commodity hedges used in the energy markets and what are examples of cross-commodity hedges in use today that do not meet the Commission's proposed bona fide hedging definition in proposed rule 150.1? How would the energy markets be impacted if market participants could not use these hedges?
10. What requirements, if any, should the Commission impose on cross-commodity hedges to ensure that such hedges are appropriately considered bona fide hedges pursuant to CEA section 4a(c)? Should the Commission exempt such hedges pursuant to CEA section 4a(a)(7) instead?
11. What are the important distinctions, if any, between recognizing a hedge as a bona fide hedge exempt from position limits pursuant to CEA section 4a(c) and simply exempting that hedge from position limits pursuant to the Commission's CEA section 4a(a)(7) exemptive authority?
12. Should the Commission permit hedges, including cross-commodity hedges, in the spot month?
13. What effect does the limitation of CEA section 4a(c)(2)(B), which limits the risk management exemption to only those swaps that would qualify for hedging treatment independently or those where the counterparty to the trade would qualify for hedging treatment, have on the ability of dealers to provide liquidity in the energy markets? If the Commission were to exercise its exemptive authority under CEA section 4a(a)(7) to permit broader risk management hedge exemptions, would a significant increase in liquidity result? Is such liquidity necessary?
14. In the energy markets, what processes have the exchanges followed to grant and review hedge exemptions?
15. What is the role of the exchanges in the Commission's proposal? Are there additional duties the exchanges can undertake to make position limits simultaneously more effective and user-friendly?
16. CEA section 4a(c)(1) specifically provides that hedging treatment should be available to "producers, purchasers, sellers, middlemen, and users of a commodity or a product derived therefrom to hedge their legitimate anticipated business needs for that period of time into the future for which an appropriate futures contract is open and available on an exchange." Does the Commission's proposal provide sufficient ability for hedging of anticipatory merchandising? What do such transactions look like?
17. If energy market participants do not receive hedge treatment for such anticipatory merchandising transactions, what consequences would result? Would it be more difficult (or expensive) for merchandising to take place? Could this result in shortages or increased volatility in particular markets?
18. Are there any other bona fide hedging issues the Commission should consider?