

Securities Regulation Daily Wrap Up, SWAPS—Bickering over position limits report dominates CFTC advisory panel, (Feb. 25, 2016)

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It is rare for an agency advisory committee meeting to produce much in the way of drama, but that is just what happened at a gathering of the CFTC's Energy and Environmental Markets Advisory Committee or EEMAC. Despite an agenda that spanned electricity and swaps markets, it was the EEMAC's new report on the Commission's proposed position limits rules that at times prompted testy exchanges between EEMAC members.

Commissioner J. Christopher Giancarlo, the EEMAC's sponsor, had opened the meeting by [warning](#) generally that the Commission must justify the costs of its regulations because its rules can make commodities market conditions better or worse, especially now when these markets are strained. As for position limits, Giancarlo urged the Commission not to proceed with adoption of final rules at least until it gets more and better swaps data. He also said a federal court ruling vacating an earlier version of the position limits rules did not require a fresh round of rulemaking. But Commissioner Sharon Bowen [renewed](#) her call to finalize the Commission's position limits rules.

Senator Elizabeth Warren (D-Mass) sent a [letter](#) to Giancarlo earlier today asking him to withdraw the report until a properly constituted EEMAC can issue another one that complies with the law. The senator, calling the report "nothing more than a recitation of industry talking points," drew attention to what she termed "procedural and factual errors" in the report and to the EEMAC's membership being over-representative of the swaps industry.

But House Agriculture Committee Chairman K. Michael Conaway (R-Tex) later [praised](#) the EEMAC's work, saying that he believed Congress never intended for the Dodd-Frank Act to curb legitimate hedging by derivatives end users. Likewise, Sen.

Pat Roberts (R-Kan), chairman of Senate Agriculture Committee, [said](#) the Commission must alter its position limits proposal to ensure that end users do not lose their ability to hedge risks.

The majority report. According to the [majority report](#), prepared by EEMAC members James Allison, JCA Advisory Services LLC, and Craig Pirrong, a finance professor at the University of Houston's Bauer College of Business, the Commission either should not adopt final position limits rules, or it should heed the report's practical advice on a variety of matters if it does finalize the proposal.

The report said there was scant evidence that the Commission's position limits rules were needed and they might flunk scrutiny under the Commodity Exchange Act's necessity requirement. Specifically, the lack of evidence that a link exists between excessive speculation and commodities futures prices may cause the proposal to fail cost-benefit analysis. A footnote to the report cited two studies that appeared to cast doubt on an earlier study that found such a link.

Likewise, the report concluded that renewed liquidity woes in physical and derivatives markets could worsen if the Commission adopts the new rules. The proposal's definition of bona fide hedge is yet another concern raised by many public commenters.

According to the report, the proposal's treatment of enumerated hedges would curb some commonly used trading strategies, including spread trades, synthetic storage, and cross hedges. Allison emphasized that the proposal offered little explanation for why these trades would be excluded.

The report also suggested how the Commission might take a more pragmatic approach to position limits if it decides to act on the proposal. For one, Allison asked EEMAC members where the CFTC would get the resources to manage a federal regime, but said that the exchanges could offer their expertise on the administration of a position accountability regime. Allison reiterated the report's recommendation that the Commission conduct separate rulemakings for spot month limits (do this first) and for outside the spot month limits (do this later).

Moreover, the report said new rules should employ updated deliverable supply estimates. Allison observed that the prior vacated CFTC rule would have required updates every two years and that recent shale oil activity was a key factor driving the staleness of current estimates.

Flawed process breeds dissent. A vigorous [dissent](#) by Tyson Slocum, the Energy Program Director at Public Citizen, Inc. and an EEMAC committee member, took issue with both the majority report's conclusions and the process by which the EEMAC prepared the report. Slocum's main objection was the lack of consultation, saying that EEMAC members Allison and Pirrong drafted the report on their own initiative, and without allowing for consultation with the wider group of associate members. Slocum also questioned the validity of the report because Pirrong may not have been an official EEMAC member when he served as co-author.

Giancarlo explained that he had asked Allison and Pirrong to prepare a report on transcripts of prior EEMACs meetings. He also noted that the EEMACS framework, a creature of Dodd-Frank Act Title VII, gave the committee a broad charter that is a challenge to implement given the breadth of its topics.

In a colloquy with Pirrong and Allison, Slocum asked how long it took to complete the report. Pirrong said the entire project took several months; Allison said transcript review took the most time. Pirrong also explained that the report cites comments in the transcripts in order to allow readers to check the report's accuracy.

Still, Slocum complained that he and others had just two weeks to review and reply to the report, while its authors had several months. Slocum said his dissent could have gone further on substantive issues if he had been given as much time as the majority enjoyed.

CFTC Chairman Timothy Massad later [said](#) the report repeats much that has been said about the proposal in other settings. Although Massad acknowledged that the report was hard on the Commission's proposal, he also noted that many of those siding with the majority report had submitted "more nuanced" public comments on the proposal and that similar limits had not damaged other markets. Overall, Massad said he hoped the

proposal would garner enough backing to impose a position limits regime, something he said Congress had directed the agency to do via the Dodd-Frank Act.

What's at stake. The Commission's re-proposed position limits rule would have required a person holding a greater than 50 percent interest in another entity to apply to the Commission for approval to disaggregate some positions. A later [supplemental proposal](#), issued in September 2015, would permit these persons to disaggregate positions via a notice filing with the Commission on the same terms as for a person who holds a 10 percent to 50 percent interest.

Chairman Massad previously emphasized how the updated proposal would retain both the Commission's proposed standard for when aggregation is required and would ensure that the Commission can demand more information about or modify an exemption. The Commission's position limits rules would alter the current accountability regime. Benjamin Jackson, president and COO at ICE Futures U.S., told EEMAC members that the regulatory choice was between the CFTC's proposal and an existing position limit regime, and not as some in the media had cast it as a choice between position limits or no limits.

The Commission issued its revamped [proposal](#) on position limits in November 2013 after a court [vacated](#) the final rules it had [adopted](#) in 2011.

Companies: JCA Advisory Services LLC; Public Citizen, Inc.

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