PUBLIC STATEMENTS & REMARKS

Opening Statement of Chairman Heath P. Tarbert before the Energy and Environmental Markets Advisory Committee

May 7, 2020

First, there is no more opportune time to salute all of the hard work being done on a daily basis by our staff here at the Commission than during Public Service Recognition Week. This work is vital to keep our markets operating—markets that are necessary to get our economy moving again. Industry has also been stepping up to the plate and we thank them for their efforts as well. Indeed, participating in fora such as this is also a public service.

Thank you to everyone participating in today's EEMAC meeting for your insights and assistance to the agency. Speculative position limits is a topic that this agency has spent a decade trying to tackle. With the feedback we receive today and comment letters on our proposal, we can get this rule right.

Overview of the Proposal

Position limits are not a silver bullet, but they can reduce volatility caused by excessive levels of speculative trading. Position limits can also help prevent corners and squeezes, as well as disruptions in delivery under futures contracts.

At the same time, speculative position limits by their very nature can limit market activity. Derivatives markets need speculative traders to provide liquidity for the producers and end-users using the markets to hedge. Without market makers and other speculative traders, these markets will become illiquid. The producers, intermediaries, refiners, and end-users that rely on derivatives markets to hedge their commodity price risk will find hedging that risk to be more expensive in illiquid markets.

So the Commission needs to be mindful of the balance we must strike. First, our limits should be high enough to permit liquidity provision and a healthy level of speculative trading. But second, the limits should be low enough to prevent that speculative trading from disrupting delivery, effecting a corner or squeeze, or otherwise causing excessive volatility.

We must also be careful that our limits only apply to speculative activity. In other words, *speculative* position limits must not apply to bona fide hedging activity. In this respect, position limits is the rare instance where the exception is as important as the rule itself. The agency has worked over ten years of proposals to develop a framework for granting bona fide hedge exemptions that reflect common commercial hedging practices.

I applaud Commissioner Berkovitz in calling this meeting to discuss both the levels to be set and the scope of the bona fide hedge exemption. We at the Commission all understand the importance of getting the bona fide hedge exemption right so that this rule does not inadvertently harm the ability of producers, intermediaries, and end-users to hedge their risks on physical commodity positions. Given the complexity of supply chains, this is especially pertinent to our energy markets.

Recent Volatility in the Energy Futures Markets

Of course, we should also look at position limits through the prism of recent price moves, particularly in energy markets. In the May WTI physically delivered contract, we have just witnessed one of the fastest and sharpest changes in supply and demand for any major commodity.

The market saw two periods in particular—mid-March and April 20—where prices for crude oil futures moved dramatically downward. In mid-March, that movement was across the curve and included two days with downward moves of over 20% in the front month. The movement in relative and absolute dollar terms was even sharper on April 20. On that day, the sharpest movement—and the only move into negative pricing—occurred in the front month contract. April 20 also happened to be the penultimate day of trading before the futures contract was settled, and after options had settled.

Position Limit Proposal's Focus on Spot Month Trading in Energies

The most extreme volatility that we saw in energies occurred during the spot month, which is where the current proposal is also focused. Spot month trading for physically delivered futures has always posed unique challenges. If a party is unable to make or take physical deliver and gets stuck holding a position during the delivery period, it can cause disruption to the market. Short sellers could get squeezed, driving up the price of the cash market. Or, as may have been the case with WTI, long holders could face difficulty in finding storage for delivered goods. This could put downward pressure on the cash markets. These issues had not occurred in non-spot month contracts or in purely financially-settled contracts. For instance, the cash-settled May WTI contracts did not experience negative prices on April 20 or 21, 2020.

Our proposal would put federal position limits in energy, metals, and non-legacy agricultural products only for the spot months. The proposal did not include federal non-spot month limits for these products. The proposal asked for public comment on that decision and I look forward to today's first panel and to comment letters on that topic.

Scope of Bona Fide Hedge Exemption

Of course, we need to focus on the bona fide hedging exemption. The proposal enumerates a number of trading strategies as bona fide hedges. As the proposal makes clear, this list is non-exhaustive. The proposal includes what I think is a practical and workable solution for non-enumerated hedges to be recognized.

However, it will be more straightforward for hedgers to access the markets through an enumerated bona fide hedge, which means the scope of those enumerated hedges is still important. The current proposal includes a number of enumerated hedges that the energy industry had asked for in prior proposal, including in particular anticipatory merchandising.

I think all of us at the Commission are still interested in understanding if there are additional hedging strategies that should be enumerated. The energy industry, where we are proposing federal position limits where none currently exist, has very unique hedging needs. We have to make sure our markets still work for people hedging price risks in the cash markets. So we need to make sure our definition of bona fide hedging covers all legitimate hedging strategies. So I am looking forward to today's second panel—and to comment letters—on the scope of the bona fide hedging exemption.

-CFTC-