Washington Watch

Continued Focus on Speculative Position Limits

By Will Acworth

It is now two years since gasoline prices spiked above $4 per gallon, and the debate continues in Washington over the role of speculation in energy futures markets. The Commodity Futures Trading Commission in January put out a proposal to establish a new position limit regime for four major energy commodities and invited public comment through April. The agency is now plowing through thousands of responses from a wide range of market participants, industry representatives, consumer groups and the general public.

The proposal is modeled on the existing position limit regime in the agricultural futures markets, in which limits are set by the CFTC in addition to limits set by the exchanges. The four energy commodities that would be subject to the CFTC's position limit proposal are light sweet crude oil, Henry Hub natural gas, New York Harbor No. 2 heating oil, and New York Harbor gasoline blendstock. Limits would be set on the level of speculative positions held in all months combined, in each month, and in the spot month. (See "CFTC Issues Position Limits Proposal" in the March 2010 issue of *Futures Industry* for more details on the proposal.)

The CFTC also held a public meeting on March 25 to consider whether the position limit proposal also should be applied to U.S. metals markets. A number of market participants were invited to speak at that meeting, including representatives of CME Group, London Metal Exchange, HSBC and J.P. Morgan.

As of publication of this article, the CFTC had not yet issued final rules and the timing for agency action is unclear. While CFTC Chairman Gary Gensler has made setting limits on speculation one of his top priorities, it is not clear whether he has enough support from the other commissioners to finalize the proposal. Three out of the five CFTC commissioners have expressed a reluctance to apply new position limits on the regulated futures markets if this pushes trading into other markets that are not subject to CFTC oversight.

"I am concerned that position limits in regulated futures markets without corresponding limits in OTC markets may result in less transparency in our markets if those presently trading on exchange move to OTC and other opaque markets to circumvent CFTC regulation," CFTC Commissioner Michael Dunn said at the agency's March 25 meeting.

The issue is likely to come back into the spotlight later this year. The U.S. Congress is in the final stages of drafting financial regulatory reform legislation that among other things would subject over-the-counter derivatives trading to regulation by the CFTC and the Securities and Exchange Commission. This legislation includes a provision authorizing the CFTC to set speculative position limits on OTC derivatives. If and when this legislation is enacted, the CFTC will be required to write rules implementing those limits.

Although the new rules may build on the same concepts as the existing proposal, the agency will not be able to implement these rules until it goes through another rule-making process, including another round of public comment. These new rules would be based on any new authority granted by Congress to impose position limits on OTC derivatives.

In addition, the agency may be required to draft new rules regarding foreign futures exchanges. The pending legislation includes a provision that would bar foreign boards of trade from offering direct access to U.S. customers if they do not meet certain conditions. One of those conditions is that they must apply "comparable" position limits to any commodity futures contracts that settle against the price of contracts listed on U.S. futures exchanges.

In the latest development on the position limit issue, the CFTC issued an advisory on May 7 reminding market participants of their obligations to comply with speculative position limits on an intraday basis, rather than only on an end-of-day basis.

"A trader whose position exceeds the applicable speculative position limit at any time during the day is in violation of the Commodity Exchange Act and CFTC regulations, even if the position is subsequently reduced to a level within the applicable limit by the close of the market for that day," the CFTC said. "Accordingly, intraday speculative position limit violations have been and continue to be subject to Commission enforcement action as violations of the Act."

Speculation Is Not Manipulation

The Futures Industry Association has consistently opposed efforts to limit the role of speculation in the futures markets and outlined its concerns about the CFTC's position limit proposal in a 30-page comment letter submitted to the agency in March. (Look for expanded coverage of industry comments on the CFTC proposal in the digital edition of *Futures Industry*.)

"Protecting price discovery and efficient price risk management is at the core of the Commission's mission under the Commodity Exchange Act. Speculation plays an essential role in furthering both of these goals," the FIA stated. The FIA also cautioned that without speculators to assume the risk that hedgers wish to avoid, futures market prices would be so volatile and unpredictable that the markets would be unable to serve the public interest in providing efficient risk management and reliable benchmarks.

In its comment letter, the FIA said it supported efforts to curb price manipulation, but it emphasized that speculation is not manipulation. "Too often, our public debate on commodity prices misses this fundamental and irrefutable point," the FIA wrote.

"In the last decade, through a combination of aggressive enforcement and pervasive market surveillance, the Commission has continued to police effectively price manipulation and attempted manipulation, especially in the energy commodity markets," the FIA wrote. "The combined CFTC and exchange systems, including large trader reporting, position accountability, targeted spot month position limits, special calls and constant vigilance, have worked and worked well.

"As new markets develop, whether over-the-counter or overseas, the Commission must adapt its market surveillance systems and Congress must update the Commission's authority, as it has done as recently as 2008. FIA strongly supports these efforts. Price manipulation corrodes the public interests in price discovery and hedging. It can never be tolerated."

The FIA also questioned the legal basis for the CFTC's proposal. The letter noted that Congress has recognized in statute that speculators provide essential liquidity to properly functioning futures markets. The Commodity Exchange Act therefore allows the CFTC to limit speculation only when the CFTC finds those limits to be "necessary" to prevent price distortions that burden commerce. The CFTC has never indicated that it found the proposal to be "necessary" as the law requires, the FIA asserted. In fact, the CFTC has cited no evidence that speculation caused energy price distortions. The FIA letter cited multiple studies that reach the conclusion that speculation did not cause artificial prices.

All too often, the FIA said, the public debate on commodity prices has been influenced by "public relations campaigns to scapegoat speculators" for causing artificially high or low prices. "Yet the FIA is not aware of any convincing or even credible evidence that large traders with speculative positions in energy futures markets have trumped market fundamentals as the determining factor in energy futures prices."

In fact, the evidence supports the opposite, the FIA wrote. In markets where position limits are imposed, such as agricultural futures, there is no evidence that the limits caused prices to move in any materially different pattern than in energy markets.

The FIA further cautioned that adopting the proposal would hurt the public interest in price discovery, efficient hedging and preventing market manipulation. In particular, the proposed limits would rob the U.S. exchange markets of liquidity that serves price discovery and efficient hedging and they would encourage more trading in non-transparent or overseas markets outside the CFTC's market surveillance systems.

Internal CFTC Document Analyzes Effectiveness of Position Limits in Fight against Price Volatility

Does it make sense to use speculative position limits as a tool against price volatility in the commodity futures markets? That is what some members of Congress have demanded in reaction to the 2008 surge in oil prices, but within the Commodity Futures Trading Commission there are doubts about the effectiveness of such a policy.

Although the CFTC has responded to the pressure from Congress by drafting a proposed rule that would apply a new set of federal position limits on energy futures, an internal document recently disclosed by the CFTC has revealed that the agency's own staff can find no evidence that past changes in position limit levels had any effect on price volatility.

According to an internal memo sent to U.S. Treasury Secretary Tim Geithner in August 2009, the CFTC reviewed academic research on a 2005 increase in the position limits applied by the Chicago Board of Trade to several agricultural futures. The CFTC also analyzed the energy markets at the New York Mercantile Exchange to see if the exchange's shift from position limits to accountability limits in 2001 had any impact on price volatility.

"In our analysis of the impact of position limits, we find little evidence to suggest that changes from a position limit regime to an accountability level regime or changes in the levels of position limits impact price volatility in either energy or agricultural markets," CFTC economists wrote in the memorandum.

The document was released to the public in response to a request by Dow Jones Newswires under the Freedom of Information Act, a U.S. law that requires the disclosure of government records to the media.

In addition, the FIA cautioned that proposed exemptions for hedging and swap dealers are unworkable. In particular, the proposed account aggregation standard "unjustifiably departs from CFTC practice and precedent," the FIA said.

Focus on Metals Market

The CFTC also held a public meeting in March to consider whether the proposed limits also should be applied to the gold, silver and copper contracts traded on Comex, a subsidiary of CME Group. Many of the participants in this meeting highlighted the potential danger that a new position limit regime would drive trading away from the CFTC-regulated markets to other parts of the world.

Evidence presented by CFTC staff as well as outside market experts made it clear that the U.S. is only one center among many in the metals markets. The gold and silver contracts traded on Comex represent 36% and 50% of the global market, respectively, while the copper contracts traded on Comex make up only 6% of the global market, CFTC research showed. London is a major center for price discovery in metals, the experts said, and trading could easily shift out of the U.S. if new position limit rules reduce liquidity.

Several CFTC commissioners asked for more information about the use of position accountability levels at Comex. Commissioners Mike Dunn and Bart Chilton questioned Thomas LaSala, CME's global chief regulatory officer, on why firms are allowed to exceed these levels. They also indicated that they would like to see more frequent reviews of these decisions and greater CFTC involvement in the process.

LaSala explained that when a market participant exceeds a certain number of contracts, it triggers an inquiry by the exchange's market surveillance group. In contrast to the "hard" limits in the front month, the exchange will allow market participants to exceed the position accountability levels if justified, he explained.

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Massive Response to CFTC Position Limit Proposal

By Will Acworth and Joanne Morrison

The Commodity Futures Trading Commission's plan to implement a new scheme for setting speculative position limits in energy markets has amassed the second-highest response to a rule-making in the agency's 36-year history. The proposal was opened for public comment on Jan. 26 and since then the agency has received 8,285 responses from the public.

Many of the comment letters came from companies, trade associations and individuals convinced that excessive speculation in energy futures was the main cause of the dramatic rise and fall of crude oil prices during 2007 and 2008. Groups such as the Air Transport Association and the Petroleum Marketers Association of America, which represent businesses directly exposed to changes in fuel prices, blamed the inflow of money from pension funds and other institutional investors for driving up energy futures prices and urged the CFTC to implement position limits to help limit future price volatility.

In fact, several groups that support regulatory efforts to curb speculation said the CFTC proposal was too weak and would not reduce price volatility sufficiently unless strengthened in various ways. One suggestion was to limit the aggregate amount of speculation to a certain percentage of outstanding positions.

"Without an overall cap on speculative interest, these limits will be ineffective in controlling excessive speculation," warned Richard Hirst, general counsel at Delta Airlines, the world's largest airline.

The vast majority of comments received at the CFTC were the result of a lobbying campaign organized by a group called the Coalition to Stop Oil Speculation. The coalition's members include trucking companies, regional petroleum marketing companies and a range of aviation-linked companies and airlines. The coalition contacted millions of people and provided them with the means to submit a form letter to the CFTC urging adoption of the proposal.

"Our tax dollars were used to bail out large Wall Street firms when they were on the brink of bankruptcy. It is these same institutions that pushed the price of gasoline well past $4 per gallon in 2008 by gambling on oil and continuing to profit at every American's expense," the form letter stated.

The proposal also has grabbed wide attention among politicians responding to pressure from voters affected by higher prices for gasoline and heating oil. "The proposed rule is necessary to curb excessive speculation in energy markets and to promote fairer and more efficient markets and energy prices," wrote Senator Carl Levin (D-Mich.), who chairs the Permanent Subcommittee on Investigations, in his May 18 comments to the CFTC.

Speculation Not the Cause

The public reaction was by no means uniform, however. A barrage of critical letters were filed by a wide range of market participants such as banks, swap dealers, commodity trading advisors and pension funds. Many of these firms vehemently disagreed with the idea that an excess of speculation in the energy futures markets caused energy price volatility and urged the CFTC to avoid taking action on the proposal until it has solid empirical evidence that such a cause-and-effect relationship exists. Many of these firms also defended the flow of institutional investment into commodity futures, arguing there is no proof that this trend has distorted commodity prices and that in fact many studies show the opposite. They also highlighted the value of this investment strategy in hedging against inflation and a declining dollar.

Some critics of the CFTC plan also warned that several provisions of the proposal, notably the aggregation and "crowding out" provisions, would be extremely difficult if not impossible to implement. The practical difficulties of complying with these provisions would be so severe, they argued, that many commercial hedgers would simply reduce their participation in the U.S. energy futures markets, leading to a reduction in liquidity and more, not less, volatility.

"We are concerned that the current proposal is premature, unnecessarily complex and operationally unworkable," said Joseph Gold, head of U.S. commodities, Barclays Capital. "We also fear that new limits could have serious unintended consequences, including a negative impact on market liquidity, corporate risk management strategies, capital investment and ultimately energy prices."

Much of the opposition came from financial institutions that would be directly affected by the proposed limits, but some commercial users of the energy futures markets also spoke out against the proposal. For example, integrated utilities, oil companies, natural gas companies and refiners raised a number of concerns, including the risk of a reduction in the liquidity of the energy futures markets and decreased ability of financial intermediaries to provide them with risk management services and long-term project financing.

"EEI respectfully submits that the practical effect of the proposed rule will be the opposite of what the CFTC intends," said Richard McMahon, executive director of Edison Electric Institute, which represents shareholder-owned utilities and roughly 70% of the entire U.S. electric power industry. "Instead of preventing excessive speculation, it will unnecessarily restrict the hedging activities of commercial market participants who need to manage the risks associated with their physical energy businesses."

Targeting Investors

For many of the proposal's supporters, the unifying theme was the extreme volatility in fuel prices in 2007 and 2008 and the impact on their profitability. Delta Airlines, for example, pointed out in its comment letter that it consumes 4 billion gallons of jet fuel annually, second only to the U.S. government. Jet fuel is

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the company's largest expense and consequently the spike in oil prices had a direct impact on its bottom line.

The U.S. Department of Transportation submitted a letter to the CFTC noting the sector's vulnerability to price shocks. The transportation sector consumes more than 25% of the energy used in the U.S., the agency said. "Hence, petroleum prices and price volatility affect transportation, and particularly transportation common carriers, disproportionately." The transportation department said it has not taken a stance on the proposal but it said that if the CFTC can provide evidence that increased speculation helped drive up prices and volatility, it would "support position limits or other remedial measures to prevent this activity."

Several groups blamed the large increase in the money invested in commodity futures and especially in commodity index funds for causing the volatility in oil prices. The Air Transport Association, for example, asserted that the "explosive growth" of these passive investment vehicles "has overwhelmed the markets with a flood of money that caused sharp increases in price that were not related to demand for actual, physical petroleum."

A similar comment came from the Industrial Energy Consumers Association, a group that represents manufacturing and chemical companies using natural gas as a fuel and a raw material. IECA urged the CFTC to distinguish between traditional speculators and institutional investors, saying that "passive investors" reduce the amount of available liquidity and harm price discovery since they only enter on the buy side of the market.

These groups therefore urged the CFTC to reduce the overall amount of speculation in the energy futures markets. IECA recommended that speculative trading in natural gas futures should be limited to 25%, the same level as 1998. The ATA recommended that the CFTC should determine an "optimal level of speculation" between 25% to 35% of open interest and then set individual trader limits to achieve that level. Such a limit should provide "more than enough liquidity to ensure efficient and effective price discovery," ATA argued.

Several groups also complained that the proposed position limit levels were too high to make a difference. The Petroleum Marketers Association of America, which represents more than 8,000 independent petroleum marketers such as gas stations and retail suppliers of diesel fuel and heating oil, said in its comment letter that the proposed limits were "overly generous" and would fail to "meaningfully constrain the excessive speculation and undue market concentration that has plagued these markets." The PMAA suggested that the CFTC instead rely on the "customary historical position sizes" held by speculative traders as the basis for setting position limit levels and look to the period before the run-up in energy prices as the baseline for that calculation.

Defending Investors

Fund managers strongly rejected the arguments that their investments in energy futures caused the spike in oil prices and warned against those aspects of the proposal that would make it more difficult for them to use the U.S. energy futures markets.

The Pacific Investment Management Company, a large U.S. money manager that manages a number of commodity index funds, noted that its customers are using their commodity investments to hedge inflation risk and other financial risks in their portfolios. "In this regard, we believe that diversified commodity index investors have more in common with commercial hedgers than they do with speculators," argued Brent Harris, the chairman and president of Pimco Funds, in his comment letter to the CFTC.

Pimco also argued that the proposed rule lacks legal and empirical justification. The firm noted the CFTC has not demonstrated that passive investment in futures has caused volatility or disrupted price formation, and added that the opposite "could just as likely be true" given the liquidity that these investors provide.

Another perspective came from Algemene Pensioen Groep, a Dutch pension fund with 240 million euros in assets. The fund said it allocates 3% of its investments to commodities to hedge against inflation and relies heavily on U.S. energy futures to achieve this goal. APG argued that passive investment has a "smoothing effect" on volatility since pension funds typically sell when prices rise and buy when prices fall in order to maintain a fixed allocation to the asset class. APG also warned that if the proposal is implemented, it will be difficult for the fund to obtain its desired allocation through the affected futures contracts, forcing it to switch to non-U.S. futures markets or over-the-counter derivatives.

"These measures will drive exposure outside of the control of the CFTC and as a result commodities will become less regulated and less transparent," APG wrote in its April 22 comment letter.

Risks to Project Finance

The Dutch pension fund added that the proposal would also drain liquidity from the system in such a way that exploration and production companies will have less appetite to develop new projects. "As a result, this will have an adverse effect of higher energy prices and lower energy security going forward."

This was echoed by companies in the energy industry concerned that the CFTC proposal could make it more difficult to secure financing for long-term investments in power plants and other infrastructure. Such projects require the hedging of price risk many years into the future, explained EEI's Richard McMahon.

"Unpredictability as to how position limits will vary from year to year may reduce the number of entities, especially financial institutions, that are willing and able to enter into hedging transactions with energy asset owners because of the uncertainty about whether they will be able to maintain effective hedges for the full duration of the projects," commented McMahon. "If our members are unable to hedge their project risk, or are forced to hedge at higher prices because of regulatory uncertainty, this will adversely affect their ability to secure funding for such projects."

The Electric Power Supply Association, which represents power suppliers accounting for 40% of the installed generating capacity in

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the U.S., expressed a similar view. "EPSA's members use financial instruments, including options and futures, to hedge the prices risks associated with new project development," the association wrote in its April 23 comments.

A more retail-oriented comment came from United States Commodity Funds, a fund manager that operates the U.S. Oil Fund, the U.S. Natural Gas Fund and several other exchange-traded funds that track commodity prices. Nicholas Gerber, the company's chief executive officer, noted each of USCF's funds has thousands of investors and no single investor has ever held more than 5% of the units outstanding of any fund. He therefore urged the CFTC to "look through" the fund and apply position limits to the underlying investors. "This would be a more rational approach since it is the funds' investors and not the funds themselves that are in fact making the buy/sell decisions resulting in the purchase or sale of energy futures contracts," he argued.

Gerber also questioned the effectiveness of position limits as a tool for combating price volatility and warned that restricting participation in the futures markets could actually increase volatility. He pointed to a number of studies, including studies by the CFTC's own staff, showing that financial investors in general and commodity ETFs in particular tended to be net sellers of crude oil futures during the run-up in oil prices, net buyers during the subsequent fall in prices, and net sellers during the more recent rise in prices.

"If the Commission presumes that large scale buying and selling of futures contracts can directly influence the price of the spot commodity, which is itself a highly debated point, then the only conclusion that can be drawn is that the actions of commodity ETFs over the last three years have been to moderate volatility in oil prices, not increase it," he wrote.

Restricting Concentration

A number of organizations, namely banks, dealers and the associations that represent them, took issue with the idea that positions limits should be tightened to reduce concentration of market share in the energy futures markets.

Conrad Voldstad, the chief executive officer of the International Swaps and Derivatives Association, said there is no statutory basis for the CFTC to adopt regulations to restrict concentration of positions and nor is there evidence of excessive speculation that would warrant the new rules. "While the focus of the proposed rule is on the undue concentration of positions, neither the CFTC nor the proposed rule defines 'concentration' in the context of energy markets or in general, provides any examples of concentration in the energy markets, or provides any evidence that the current concentration of positions has harmed, or had any impact on the market for the referenced energy commodities," Voldstad wrote. "Furthermore, the proposed rule does not provide any data or information to justify the focus on concentration, making it difficult to evaluate the purpose or effect of the proposed rule," he stated.

The association said it is "deeply concerned" that the focus on concentration will arbitrarily impact specific market participants, with little or no justification for such restrictions. "The reduction of concentration in the energy markets as contemplated by the proposed rule as a potential 'remedy' for excessive speculation is unsupported and should be reconsidered," ISDA's Voldstad wrote.

Barclays Capital offered a further argument against restricting concentration. Joseph Gold, the bank's U.S. head of commodities, submitted a lengthy explanation of the bank's role as a provider of risk management and the potential problems that the CFTC proposal would create. Gold argued that commodity markets often have a limited number of buyers and sellers and it is necessary for intermediaries to have "scale and expertise" in order to manage risks, especially the "chunky" risks involved in large infrastructure projects.

Swap dealers are not merely hedging client risk "back-to-back" in the futures markets, he explained. Instead their hedging is a dynamic process that may involve multiple transactions and a variety of instruments. Limiting the ability of swap dealers to manage large risks will reduce market's overall ability to absorb these risks, he warned.

"We know there are some who have a 'build it and they will come' attitude and who believe that many new smaller players will step in to fill the void," Gold added. "Our concern is that the new entrants may lack the required expertise, infrastructure, capital and scale of operations required to be able to properly analyze and manage these risks."

Practical Problems

A large number of market participants also took issue with the practical application of the proposal, including a plan that would require the aggregation of positions held by all entities under common ownership. This would be a big change from current practice, and was deemed unworkable and impractical given the complexity of corporate structures and the legal restrictions against the sharing of information between entities.

APG, for example, explained that it invests in numerous funds and companies. "In practice it would be quite impossible for us to monitor our aggregated positions across all investments, on a daily basis, to ensure compliance with the applicable speculative position limits and prevent our positions to breach a limit," said the Dutch pension fund.

American Gas Association, a trade group that represents companies that deliver natural gas to U.S. customers, agreed that this standard would be impractical. The proposed aggregation standard would create "significant compliance issues" for gas companies that are affiliated with electric utilities, natural gas exploration and production companies, or other energy-related companies, said Andrew Soto, the AGA's senior managing counsel of regulatory affairs.

The aggregation requirement also would conflict with federal banking regulations that prohibit sharing of information between certain banking affiliates, warned Merrill Lynch Commodities, the commodity arm of Bank of America Merrill Lynch. The company noted that other business units within the parent holding company make direct investments in

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third parties that actively trade commodities. MLCI does not have knowledge of those third party trading activities and is required by its banking regulators to maintain a clear separation, the company said.

Joanne Medero, managing director at BlackRock, a U.S. fund manager with $3.3 trillion under management, warned that the proposed aggregation standard would be a disruptive change to current practices and would reduce the liquidity of U.S. energy futures markets.

"Disaggregation based on the independence of control over trading decisions has been a long-standing policy of the Commission, premised on a recognition that accounts that are under separate management need not be, and should not be, aggregated because they have no combined effect on the market," Medero explained. "Asset managers may utilize both passive and active trading programs, which by their very nature are based on different investment decisions and time horizons. Asset managers also participate in fund of funds' structures in order to provide their investors access to diversified independently managed investment strategies. As the Commission has recognized for most of its 40-year existence, there is no reason to aggregate these independent positions because different investment approaches provide (and require) different types of market liquidity."

Crowding Out

Another area of concern was the proposed "crowding out" provision. Under this part of the proposal, commercial users could continue to seek an exemption from the speculative position limits if they are engaged in bona fide hedging. The exemption would not apply, however, if they engage in any speculative activity. In practical terms, this would mean that no company could exceed the limit if they engaged in even a minimal amount of speculation.

Such an approach would be "extremely burdensome and most likely nearly impossible," commented Dennis Stieren, vice president of trade operations at Gavilon, a commodity merchandiser and trading company based in Nebraska. Stieren explained that commercial hedgers like Gavilon hold complex portfolios of energy futures, options, swaps and physical positions. Hedging these portfolios is a dynamic process that takes into account market conditions and fundamental factors that are constantly changing. At any moment a position could be sold and the associated hedge could be considered speculative.

"For example, a refinery customer may call late on a Friday after the futures market closes and purchase crude oil that a commercial entity has in inventory," Stieren explained. "Once the entity has sold that crude oil, its futures position hedge is no longer a hedge…and could be considered in violation of its hedge exemption."

A similar comment came from Shell Energy North America. Robert Reilley, the company's vice president of regulatory affairs, said that Shell, like many participants in the energy trading markets, cannot be "bucketed" as a hedger, speculator or swap dealer. He explained that the company seeks to manage risk and optimize value across physical and financial, exchange-traded and over-the-counter markets.

"Shell Trading takes speculative positions and it enters into swap transactions related to energy commodities with a variety of counterparties to offset its risks, including credit risks, and to facilitate physical transactions," Reilley wrote. "By failing to recognize the nature and scope of the energy commodity merchant business, the proposed rule may create unintended limitations on legitimate activities."

Reilley added that the "crowding out" provision would create "a significant disincentive" to obtain hedge exemptions. "Shell Trading seriously questions the rationale for such a prohibition, but also has the practical concern that, in many cases, positions held for hedging are indistinguishable from those that might be held speculatively," he cautioned.

Another practical problem is that the CFTC's proposal would rely on annual averages for calculating position limit levels. This would fail to take into account any fluctuations in open interest levels due to seasonal factors or extreme market events, warned David Harding, founder and head of research at Winton Capital Management, a large managed futures fund and hedge fund manager based in the U.K. Winton therefore recommended that the CFTC consider using seasonal adjustments or resetting limits more frequently, as some exchanges already do.

"The proposal to set speculative position limits annually based on a simple average may result in sizeable fluctuations in the ratio of the speculative position limits to actual open interest levels, due to the seasonality of the referenced energy contracts," Winton wrote. "As open interest fluctuates over the course of a year, the speculative position limits will become weaker or stronger depending on the point during the cycle. Such fluctuations may impact the effectiveness of the limits."

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