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– FACT SHEET –

The CFTC's Proposed Position Limits Regulations Would Not Adequately Curb Excessive Speculation

On May 15, 2020, Better Markets filed a comment letter on the Commodity Futures Trading Commission's (CFTC) proposed rulemaking establishing a substantially revised speculative position limits framework. [Our full comment letter can be accessed here]. For nearly 10 years, Better Markets has called on the CFTC to lawfully implement a meaningful speculative position limits framework for derivatives (futures, options on futures, and swaps) referencing physical commodities.

There are elements of the CFTC's proposal that have merit, and some would represent progress in implementing a federal position limits framework. However, the CFTC's fifth proposal in 10 years continues to suffer from significant legal and policy deficiencies that must be remedied before finalization. The proposal's five most material deficiencies are as follows:

1. **The federal spot-month limits for derivatives on the 25 physical commodities subject to the most critical elements of the proposal would generally represent significant increases in permissible speculation.**

   The proposal would dramatically increase federal position limits for legacy agricultural contracts and establish new federal position limits that greatly exceed most exchange-set limits for derivatives on the other physical commodities subject to the most critical elements of the proposal. The proposal would, however, establish federal spot-month position limits on futures contracts on 25 core physical commodities (Core Referenced Futures Contracts), as well as linked cash-settled futures and options contracts and economically equivalent swaps (collectively, Referenced Contracts).

2. **The proposal would not establish federal position limits for non-spot-month derivatives contracts on 16 of the 24 physical commodities subject to the most critical elements of the proposal**.

   Federal position limits for derivatives on nine agricultural commodities have been implemented for decades for single months beyond the spot month and all-months-combined. Although the proposal expands the reach of federal spot-month position limits to derivatives on additional types of agricultural, energy, and metals commodities, the proposal would not apply federal (non-spot-month) single-month and all-months-combined position limits in 16 of the 25 Core Referenced Futures Contracts.

   Furthermore, a proposed default formula that would be used by exchanges to calculate non-spot single-month and all-months-combined position limits would be considerably more permissive than the current formula used by the major DCMs.

3. **The proposal would dramatically expand (almost triple) the number of self-effectuating enumerated exemptions and for the first time recognize a broad exemption (read, loophole) for anticipatory merchandising.**

The proposal would implement numerous expansive and self-effectuating "hedging" exemptions from position limits, including multiple new exemptions for anticipatory merchandising and other anticipatory trading strategies supposedly in the nature of "bona fide hedging transactions or positions." As a consequence, the proposal would exclude an unknown percentage of total positions from the federal and exchange limits framework and in a manner that all but eliminates meaningful constraints on speculation in derivatives markets on key physical commodities.

4. **The proposal would implement a new process for recognizing non-enumerated hedging strategies that practically eliminates CFTC oversight.**

   The proposal would permit exchanges to grant non-enumerated bona fide hedging exemptions for purposes of federal and exchange position limits. The CFTC's oversight of exchange determinations with respect to such hedging exemptions would be limited by the impractically short review periods for exchange-approved hedges. Although the proposal would provide authority for the CFTC (and not its staff) to stay and/or object to such determinations, the proposed review process would risk reducing the CFTC's supervisory role to mere notice on the most complex hedging applications.

5. **The proposal would raise unnecessary administrative hurdles and open avenues for legal challenges to meaningful position limits by interpreting ambiguities in the Commodity Exchange Act (CEA) to require a "necessity" finding before the CFTC could finalize federal position limits.**

   The proposal includes a preliminary determination that the CFTC must make an antecedent "necessity" finding that establishing federal position limits is "necessary" for each of the 25 Core Referenced Futures Contracts. The CFTC's factors in determining as much are reasonable in a number of respects. However, the CFTC includes a lengthy legal analysis that reverses the CFTC and CFTC staff's longstanding legal views that ambiguities in the CEA, ***if any***, should be construed, in light of agency expertise, to **require** position limits on derivatives on physical commodities.

   The legal analysis and broad factors provided in the proposal are unlikely to limit the CFTC's practical ability to impose federal position limits. Nevertheless, the legal analysis contravenes a better reading of CEA's statutory commands and congressional intent (including the reading articulated in the CFTC's 2016 position limits proposal). The "necessity" findings also unnecessarily raise administrative hurdles and open avenues for legal challenges to the CFTC's position limits framework.

For the above reasons, others discussed in our comment letter, and still others not addressed in the proposal at all (e.g., the sudden or unreasonable fluctuations or unwarranted changes in the price of physical commodities caused by excessive speculation through exchange-traded funds, commodity index funds, and similar speculative vehicles), Better Markets is unable to support the CFTC's position limits proposal. We acknowledge certain positive elements of the proposed position limits framework in our comment letter. However, the potential for implementation of federal position limits that do not actually limit speculation remains too great.

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