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CFTC PROPOSES POSITION LIMITS ON ENERGY FUTURES CONTRACTS MODELED AFTER AGRICULTURAL LIMITS

At a public hearing on January 14th, CFTC Chairman Gary Gensler called for the setting of position limits on the energy futures and options contracts based on the limits imposed on the agricultural contracts. Gensler, who has taken an active role in attempting to deal with price distortions attributed to large speculative interests. During the hearing, Gensler said:

> "The CFTC is charged with a significant responsibility to ensure the fair, open and efficient functioning of futures markets. Our duty is to protect both market participants and the American public from fraud, manipulation and other abuses. Central to these responsibilities is our duty to protect the public from the undue burdens of excessive speculation that may arise, including those from concentration in the marketplace."
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> "The CFTC is directed in its original 1936 statute to set position limits to protect against the burdens of excessive speculation, including those caused by large concentrated positions. In that law – the Commodity Exchange Act (CEA) – Congress said that the CFTC "shall" impose limits on trading and positions as necessary to eliminate, diminish or prevent the undue burdens that may come as a result of excessive speculation. We are directed by statute to act in this regard to protect the American public.
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> "A transparent and consistent playing field for all physical commodity futures should be the foundation of our regulations. Thus, position limits should be applied consistently to all markets and trading platforms and exemptions to them also should be consistent and well defined. While we currently set and enforce position limits on certain agriculture products, we do not for energy markets. Though there are some differences between energy markets and agricultural markets, those distinctions do not suggest to me that the federal government should set position limits on one and not the other. "

The proposed limits would cover the Henry Hub natural gas, light sweet crude oil (such as West Texas Intermediate or WTI), New York Harbor No. 2 heating oil and New York Harbor gasoline blendstock, and are intended to limit the concentration of positions and promote fair and orderly markets.

Under the proposal:

- The aggregate limits are set by formula based on open interest. The all-months-combined position limit would be 10 percent of the first 25,000 contracts of open interest and 2.5 percent of open interest beyond 25,000 contracts. The singlemonth position limit is set at two thirds of the AMC position limit. The spot-month limit in the physical delivery contract is 25 percent of the estimated deliverable supply.

- To promote competition, for a small reporting market, the AMC limit would be up to 30 percent of a
contract's total open interest on that exchange. The single-month limit that would apply to a small exchange would be equal to two thirds of that value – or as much as 20 percent – of the total open interest on that exchange. For new reporting markets, a de minimis AMC limit would be the greater of 5,000 contracts or one percent of all open interest in a referenced energy commodity contract.

- A trader holding cash-settled contracts would be subject to a spot-month position limit of five times the level fixed for the cash-settled contract's physically-settled counterpart if the trader holds no physically settled contracts in the spot month. Otherwise, traders would be subject to the same limit fixed for a contract's physically-settled counterpart. Pursuant to recently adopted exchange rules, this is the same methodology for spot-month speculative position limits that applies to cash-settled Henry Hub natural gas contracts on NYMEX and ICE, beginning with the February 2010 contract months.

According to the CFTC staff, in addition to exempting bona hedgers from position limits, the proposed rule establishes a consistent framework for certain swap dealer risk management exceptions.

- Maintains exemptions for entities using the futures markets to hedge commercial risks. Those traders, such as an airline purchasing futures contracts to hedge the cost of fuel, would qualify for a *bona fide* hedging exemption from the proposed position limits.

- Brings uniformity to swap dealer exemptions; exemptions would be consistent, and the names of the exempted dealers would be publicly disclosed. Swap dealers establishing positions to offset customer initiated swap positions could qualify for a limited risk management exemption for positions held outside the spot month. The limited risk management exemption for swap dealers would be administered by the CFTC and capped at two times an otherwise applicable proposed position limit (*i.e.*, an AMC or single-month limit).

  To qualify for a swap dealer risk management exemption, the dealer must file an exemption application and update the application annually.

> The swap dealer also must provide monthly reports of their actual risk management needs and maintain records that demonstrate their net risk management needs. The CFTC would publicly disclose the names of swap dealers that have filed for an exemption after a six-month delay.

- Treats bona fide hedgers and swap dealers similarly to the practice of certain exchanges that independently administer an agricultural speculative position limit framework. The proposed regulations would count *bona fide* hedging transactions against a trader's ability to hold speculative positions. For example, a trader holding *bona fide* hedging positions greater than a proposed Federal speculative position limit would not be able to simultaneously hold a speculative position. Further, a trader's swap risk management position also would count against a trader's ability to hold speculative positions.

The proposal will be published in the Federal Register this week and the general public has 90 days in which to submit comments.

LINCOLN, CHAMBLISS COMMEND KIRK ON WTO POSITION-COTTON HIGHLIGHTED

U.S. Senate Agriculture, Nutrition and Forestry Committee Chairman Blanche Lincoln, D-AR, and Ranking Member Saxby Chambliss, R-GA., wrote to U.S. Trade Representative (USTR) Ron Kirk commending him on strongly defending the U.S. position at the World Trade Organization (WTO) ministerial meeting last December in Geneva. The Senators praised his call for an ambitious agricultural market access agreement within the Doha Development Round.

They highlighted the importance of maintaining the "single undertaking" approach with respect to cotton, which ensures that no separate agreements affecting U.S. cotton programs would be signed outside of a comprehensive agreement of the Doha Round. They emphasized that such an insistence is specifically important to maintain the Senate's support for and confidence in the multilateral negotiations.

"We greatly appreciate Representative Kirk's strong defense on behalf of U.S. agriculture as we negotiate with our partners around the world," the Senators said. "With U.S. cotton production and exports down more than 40 percent in the past five years, it is time for critics to stop focusing on U.S. policies, and to start taking note of the market distortions caused by trade barriers imposed by major importing and other cotton exporting countries. Throughout the negotiations we clearly stated that our support for an agreement in the Doha Round is contingent on a market access agreement that lowers such trade barriers. We cannot support a one-sided agreement that exposes our farmers and ranchers to a greatly reduced farm safety net without corresponding improvements in market access."

They also stated, "We were particularly pleased with your comments regarding cotton. Congress has twice amended statutory authority for the U.S. cotton and export credit programs legislation, and the Department of Agriculture has made administrative changes to the GSM-102 program in response to critics and the WTO dispute settlement body's decision….While we are willing to support a negotiated solution to the cotton portion of this dispute, Brazil must acknowledge that market conditions have changed, and any resolution also needs to reflect the realities of today's market. We believe it is imperative for a solution to the cotton case to be incorporated into the single undertaking of the Doha Round."

PRESIDENT OBAMA PROPOSED BANK FEES TO RECOUP TARP FUNDS

President Barack Obama proposed a Financial Responsibility Fee to recoup the debt of the largest U.S. financial firms who received Troubled Asset Relief Program (TARP) funds to assist them through the 2007-08 financial crisis. The fee, which requires Congressional authorization, would remain in place for 10 years or longer if necessary to fully pay back an estimated $117 billion in TARP funds. In announcing his decision, the President said:

> "My commitment is to recover every single dime the American people are owed. And my determination to achieve this goal is only heightened when I see reports of massive profits and obscene bonuses at the very firms who owe their continued existence to the American people – who have not been made whole, and who continue to face real hardship in this recession. That's why I'm proposing a Financial Crisis Responsibility Fee to be imposed on major financial firms until the American people are fully compensated for the extraordinary assistance they provided to Wall Street."

While more complete details of the proposed Financial Crisis Responsibility Fee will be released in conjunction with the President's budget, the basic outline of the fee is as follows:

- **Fee Applied Only to Firms with More Than $50 Billion in Consolidated Assets**: The fee would only be applied to firms with more than $50 billion in consolidated assets. No small or community bank would be covered by the fee.

- **Fee Would Cover Banks and Thrifts, Insurance and Other Companies That Own Insured Depository Institutions, and Broker-Dealers**: Covered institutions would include firms that were insured depository institutions, bank holding companies, thrift holding companies, insurance or other companies that owned insured depository institutions, or securities broker-dealers as of January 14, 2010, or that become one of these types of firms after January 14, 2010.. These institutions were recipients and/or indirect beneficiaries of aid provided through the TARP, the Temporary Liquidity Guarantee Program, and other programs that provided emergency assistance to limit the impact of the financial crisis.

• **Both Domestic Firms and U.S. Subsidiaries of Foreign Firms Subject to the Fee**: The fee would cover the liabilities of all firms in these categories organized in the U.S. – including U.S. subsidiaries of foreign firms. Operations of U.S. subsidiaries of foreign firms in the areas cited above would be consolidated for the purposes of the $50 billion threshold and administration of the fee. For those firms headquartered in the U.S., the fee would cover all liabilities globally. The Administration will also work through the G-20 and the Financial Stability Board to encourage other major financial centers to adopt comparable approaches.

• **Fee Assessed at Approximately 15 Basis Points (0.15 Percent) of Covered Liabilities Per Year**

• **How Liabilities Subject to the Fee Would Be Determined**: Liabilities subject to the fee would be defined as: *Covered Liabilities = Assets - Tier 1 capital - FDIC-assessed deposits (and/or insurance policy reserves, as appropriate)*

• **Exempting FDIC-Assessed Deposits and Insurance Policy Reserves As Appropriate**: The fee will exempt FDIC-assessed deposits because they are stable sources of funding covered by deposit insurance and already subject to assessment. Similarly, the base for the fee would be appropriately reduced based on insurance policy reserves.

• **How the Fee Would Be Assessed**: Covered liabilities would be reported by regulators, but the fee would be collected by the IRS and revenues would be contributed to the general fund to reduce the deficit. The Administration will also work with Congress and regulatory agencies in order to design protections against avoidance by covered firms.