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Statement

"Going Slow" Is Not an Option

Statement of Commissioner Bart Chilton Hearings on Position Limits and Hedge Exemptions, Washington, D.C

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Within days of the announcement by the chairman of the Commodity Futures Trading Commission that he would convene hearings this summer to address excessive speculation issues in commodity markets, particularly energy markets, the push-back began: a chorus of voices warning against overreaching regulatory action and urging the CFTC not to move too fast on its oversight agenda. Such "go-slow" requests are not unexpected, inasmuch as changes to address unwarranted speculative activity—possible imposition of limits on futures trading in energy commodities and redefining the concept of "true" hedging—could, if enacted, affect the way companies have done business for decades. Taking into account, however, the unprecedented volatility in commodity markets over the past year, the contagion to linked international markets, and the resulting harm to ultimate consumers worldwide, the only responsible answer to these requests has got to be that, in whatever manner the agency proceeds, "going slow" is not an option.

That does not mean that we will act capriciously or irresponsibly; the twin objectives of speed and wisdom are not mutually exclusive. It does mean that we need the best and brightest minds brought to bear quickly on these issues, to determine what appropriate regulatory responses should be put in place, if necessary. And not just for energy markets, but for other commodities as well—including metals—if the facts warrant such regulatory oversight.

The naysayers use a common debating tactic, that is, to frame the debate as a choice of unreasonable alternatives. This forces deliberations off-course, driving opponents to argue against one straw man after another. For example, the "go slows" have argued that any changes to speculative or hedging rules would impair the ability of markets to effectively discover prices, or move market participants into opaque markets, or negatively affect the ability to effectively manage risks, or unfairly impact prices for consumers. The CFTC would not, of course, enact any policy changes with those results, yet all of these charges have been leveled at the agency, even before the first word of testimony is heard.

A similar maneuver was attempted last year when the CFTC used its administrative authority to address the "London Loophole," that is, the inconsistency in regulatory treatment of "look-alike" energy contracts trading on both New York and London futures marts. As soon as the agency announced its intended action—to regularize position limits and reporting requirements—the hue and cry arose by those who would have stymied the effort, opining that the CFTC was engaging in "excessive" regulation of an overseas entity, in violation of the U.K. law. Of course, no such action was intended by the CFTC, nor, indeed, did any such allegation occur on the part of the U.K. Indeed, the international cooperation and coordination of regulatory oversight of these linked markets has, as intended, provided needed market data and transparency over the past year. But the "go-slows" tried to derail the effort, just as they are trying now to throw a monkey wrench in to new reform efforts for energy markets.

The real policy debate in the current matter—and the real work to be done—centers around, I believe, some of our notions of what fundamental terms mean. The words "speculation" and "hedging" are all too often bandied about, without a great appreciation for their multi-layered and interdependent meanings. Let's start from the premise that speculation is not a four-letter word. Speculators play a critically important and valuable role in the hedging and price discovery process in futures markets. They provide liquidity for the commercial hedgers in the marketplace and, traditionally, eliminate much of the volatility. But certainly there needs to be an appropriate balance between the amount of commercial hedging and the amount of speculation going on in these markets. Where is that balance? That is the policy debate that the CFTC hearings are intended to develop.

There is no doubt that futures markets have changed. They are no longer dominated by commercial hedgers, like utilities, refiners, and airlines, but rather, are flush with "new, non-traditional" participants, such as pension funds, university endowments, hedge funds and index portfolios. This new asset class of investors views the energy complex of commodities not as a hedge against energy costs, but as an investment to protect against long-term inflation and a way to diversify portfolios. The new traders play a large role—some would say an excessively large role—in the buy-side of the market, and, unlike traditional futures trading, they stay in the market for extended periods of time, often continuously rolling from one delivery period to another. This represents a tectonic plate shift in futures market operation, and raises some obvious questions as to whether rules that have been in place for decades now need to be reviewed in light of new market conditions.

It is axiomatic that we need to adapt to the environment in which we find ourselves. These are free markets, and investors have a right to enter and exit as they deem suits their business needs. The CFTC has never been in the business of saying, "there's no more room for investors here." We are in the business, however, of ensuring that actions of market participants, individually or as a group, aren't having unintended or uneconomic effects on our markets or on prices. A delicate balancing act? Yes, but that's what we get paid for—that's our job. And if we're not doing it, we shouldn't be here. Quite candidly, last year the agency did not perform its due diligence function with as much zeal as it should have, and I am pleased to see that we're finally on the right road.

In addition to quick administrative action to review issues related to position limits and hedge exemptions, I'm looking forward to prompt Congressional action to provide CFTC with the needed authorities to effectively oversee "dark markets," including the ability to require reporting, recordkeeping, clearing as appropriate, as well as necessary enforcement authorities to protect against fraud and manipulation. These are specific areas in which we can improve our regulatory oversight, and provide a real benefit to the American taxpayer and to the economy.

In the end, the CFTC must ensure that all participants have all the access they need to use these markets for their fundamental purposes – hedging risk and discovering prices. And we need to do it in such a way that consumers don't pick up the tab.