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Statement

Opening Statement of Chairman Gary Gensler, Hearing of the Commodity Futures Trading Commission

July 28, 2009

Good morning. I call to order this meeting of the Commodity Futures Trading Commission. This is the time and place announced to the public pursuant to the Sunshine Act for the first of three hearings on whether federal position limits should be set by the CFTC for commodities of finite supply.

I would like to start by thanking my fellow Commissioners and our distinguished witnesses for being here today. In particular, thank you Senator Sanders and Congressman Stupak for testifying before the Commission.

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 the market participants and the American public from fraud, manipulation and other abuses. Central to this responsibility is our duty to protect the public from the undue burdens of excessive speculation.

The CFTC does not set prices; however, the Commission ensures that commodity markets are fair and orderly. The work we do and the policies we implement have meaningful implications on the day-to-day lives of the American people. Futures markets not only provide critical risk management for farmers, producers and other market participants, but they also affect the decisions families make around the dinner table.

Gasoline prices, for example, can determine whether a family takes a summer vacation. Natural gas futures contracts can affect utility bills, and lack of convergence in the wheat market can shorten a grocery list.

It is our job to make certain that futures markets work for the American people. It is also essential that we ensure fair and orderly markets for investors and hedgers looking to minimize risk.

Immediately after I became Chairman of the CFTC, I called my staff into my office and directed them to research and outline every authority available to the agency to protect the markets and the public. Every option must be on the table. I believe that it is central to our mission to aggressively use all existing authorities to ensure market integrity and efficiency.

It is clear that the CFTC has significant statutory authority to set strict position limits in energy markets. The Commodity Exchange Act states 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. While we currently set and enforce position limits on certain agriculture products, we do not for energy markets. Instead, the exchanges set energy position limits only in the last three days of trading to address manipulation and congestion. The exchanges, however, are not required by statute to set and enforce position limits to address the burdens of excessive speculation.

The exchanges currently use accountability levels to monitor the size of positions in the energy markets. These should not be confused with position limits. Whereas position limits are strict restrictions on the size of a position a speculator can take, accountability levels are merely a way to provide the exchanges with additional oversight tools when a speculator’s position exceeds a certain size. If a position limit is a stop sign, accountability levels shouldn’t be confused with yield signs. They are a way to alert the exchanges of growing positions. Nearly 70 parties exceeded accountability levels on the four major energy contracts in the last 12 months.

The exchanges do have the authority to ask market participants to take their positions down after passing accountability levels or refrain from increasing their position. They have used this authority to a degree. The majority of the time, however, the exchanges do not execute their authority to require participants to decrease or refrain from increasing the size of their positions.

This hearing is an opportunity to determine how speculative position limits could be used to address excessive speculation, not how we can eliminate speculation. Let me be clear: the CFTC recognizes the importance of speculators to the effective operation of futures markets – markets that benefit the American public.

They allow farmers, grain elevator owners, oil producers and oil users to hedge their risk and have a marketplace where prices are determined in a fair and orderly way. Speculators who do not necessarily grow the wheat or store the oil provide necessary liquidity by being on the other side of the trade with the farmer and the oil producer. If a wheat producer or an oil producer wants to be certain of the price that they will get, or if a utility company wants to be certain of the price of natural gas they will purchase, they need speculators. Speculators have been at the heart of the futures markets for more than a century.

While speculators are essential participants, Congress long ago recognized that there may be burdens to the economy when the market becomes too concentrated. Congress directed us in our original statute in 1936 to regulate against the burdens of excessive speculation. Congress gave the CFTC an important tool – position limits – and they directed us to use them.

When the CFTC set position limits for certain agricultural commodities, the agency sought to ensure that the markets were made up of a broad group of market participants with a diversity of views. The intent was to avoid the concentration of positions of any single party.

In 1980, the CFTC reiterated its goal to prevent market concentration. In its rulemaking, the Commission stated that "a trader's net position has a continued effect on price, and if sufficiently large can become a perceptible market factor… [S]peculative position limits serve to decrease the potential for positions to influence the general price level. Moreover, by limiting the ability of one person or group to obtain extraordinarily large positions, speculative limits diminish the possibility of accentuating price swings if large positions must be liquidated abruptly."

To the extent that financial parties, such as money managers, hedge funds and swap dealers, participate in the futures markets, position limits have the potential to increase liquidity by reducing the positions of the largest traders. Position limits can enhance liquidity by promoting more market participants rather than having one party that has so much concentration so as to decrease liquidity.

I believe we must seriously consider setting strict position limits in the energy markets. This morning's hearing and the two to follow will help inform this Commission of the merits of possible new rules to set limits to protect the American public.

As a regulator, we have to ensure for market integrity both when the skies are clear and when there are storms on the horizon. As we consider the effects of large, concentrated positions on the markets, our regulations should address times of volatile or uncertain markets as well as when the markets are stable.

I was pleased to read in the written testimony of the Chicago Mercantile Exchange that it supports adoption of a hard limit regime, including single-month and all-months limits. It is a significant development at the start of these hearings that a major exchange has expressed support for hard position limits. This announcement represents tangible progress, and I welcome it.

Nevertheless, several very important questions remain:

1. What formula should be used to determine where position limits are set?
2. Who should set them – the CFTC or the individual exchanges?
3. Should noncommercial exemptions be provided for financial risk management?

On the first question, I look forward to hearing from our panelists on what they believe to be appropriate position levels. For example, what quantitative measures should be used in setting limits on the size of an individual trader's position? Should limits be established by percentage or proportion of the open interest of the market or by fixed number of allowed contracts? Should limits apply in all months combined, in individual months, and in the delivery month? How should spread trades be incorporated in this calculation? While we could have a debate on the specific levels, the goal remains to prevent concentration to lower clearinghouse risks and protect market integrity.

The question of who should set position limits is one that has been debated for more than seven decades. Senator Arthur Capper – one of the coauthors of the original legislation to regulate commodities – pressed the then-Vice President of the Chicago Board of Trade, Siebel Harris, on this point in a 1936 hearing. Harris was arguing that the exchanges should set their own limits, when Sen. Capper asked, "I take it that your position all hangs on this point, that you want the board of trade to make all the rules and regulations governing the grain trade rather than an impartial agency of the Government that will function in the interest of all parties interested?"

I believe that the CFTC's mission is to protect the interest of the American public, and it should be this agency that sets the rules and regulations on our futures markets. As we move forward in considering position limits, I believe that we should apply consistent, across-the-board regulations to all futures market participants. With competing exchanges, regulations must be applied equally to similar contracts in different markets. The CFTC is in the best position to apply limits across different exchanges, and we are most able to strike a balance between competing interests and the responsibility to protect the American public.

The third question is whether or not we should grant exemptions from position limits to persons using the futures markets to manage purely financial risks rather than risks arising from the actual use of a commodity. Although our statute directs the Commission to set position limits as necessary to prevent undue burdens on commerce, Congress also made it clear that position limits would not apply to bona fide hedgers. The statute provides the Commission with discretion to determine what constitutes a bona fide hedging transaction. Traditionally, bona fide hedging has involved offsetting commercial risks rather than purely financial risks.

There are three different categories of exemptions from position limits as we currently define them for agricultural commodities:

1. Commercial parties with physical inventory and sales;

2. Commercial parties with physical anticipatory needs; and

3. Those who file under Section 1.47 of our rules. These parties neither have inventory nor are commercial parties with anticipatory needs. For example, these exemptions are sometimes given for risk management and swap dealers.

It is the third category of hedge exemptions – the exemptions for noncommercial entities such as swap dealers – that currently risks swallowing the rule. The Commission is taking a close look into whether to eliminate these hedge exemptions for certain swap dealers and possibly create a new risk management exemption.

As we consider setting position limits on futures exchanges, I believe that the Commission must urgently work with Congress to secure additional authorities, including aggregate position limits, to prevent market participants from moving to the over-the-counter market or onto foreign exchanges. The CFTC must be able to set aggregate limits on all persons trading OTC derivatives that perform or affect a significant price discovery function with respect to regulated markets that the CFTC oversees. Such position limit authority should clearly empower the CFTC to establish aggregate position limits across markets in order to ensure that traders are not able to avoid position limits in a market by moving to a related exchange or market, including international markets.

I am looking forward to hearing from everyone who is participating in today's hearing. I believe that we have a diversity of points of view that will provide for a thoughtful discussion on this very important subject. I will also note that written comments on the topic of this hearing will be accepted from the public until August 12th, 2009, and included in the record. Based up what we learn from these hearings, we will further review CFTC rules to determine what course of action is most appropriate.

I will now turn to Commissioner Dunn for his opening statement.