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Oil, Gas Market Speculation May Face Restrictions (Update4)

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By Tina Seeley



July 7 (Bloomberg) -- U.S. regulators say **they may clamp down** on oil and gas price speculators by limiting the holdings of energy futures traders, including index and exchange-traded funds.

The Commodity Futures Trading Commission will hold hearings this month and next to explore the need for government-imposed restrictions on speculative trading in oil, gas and other energy markets, Chairman **Gary Gensler** said today in a statement.

The hearings come amid increased scrutiny of the impact of speculators on oil prices. Senator **Bernie Sanders**, a Vermont independent, and Representative **Bart Stupak**, a Michigan

Democrat, blame speculators for last year's surge in crude-oil prices to a record \$147.27 a barrel and called for CFTC action to avert a repeat. Oil has climbed 41 percent this year in New York trading, while demand has dropped and inventories climbed.

"Our first hearing will focus on whether federal speculative limits should be set by the CFTC to all commodities of finite supply, in particular energy commodities such as crude oil, heating oil, natural gas, gasoline and other energy products," Gensler said in the statement. "This will include a careful review of the appropriateness of exemptions from these limits for various types of market participants."

Among the questions the agency will ask is whether it needs additional authority from Congress to apply the limits across all markets, Gensler said. The agency didn't specify dates when the hearings would take place or who would be asked to speak.

In an interview last week, the chairman, who took office in May, said he had called on the agency's staff to review all available options for ensuring fair markets.

'Sign of Life'

"The CFTC has the authority to do a whole series of things to fix what's wrong with these markets, they just have not had the will to do so," Senator **Byron Dorgan**, a North Dakota Democrat who voted against Gensler's nomination, said in a phone interview today. It is the "first sign of life at the CFTC for a long while. We thought we were going to have to have a memorial service for that agency."

The Futures Industry Association, which represents the world's largest futures brokers, issued a statement saying it "would be concerned by any measures to bar legitimate participants from these markets or that would make it less efficient for U.S. corporations to use futures as a tool for managing price risk."

Shares of Intercontinental Exchange Inc. and CME Group Inc., owners of futures markets where energy contracts are traded, fell after the CFTC plan was announced.

Atlanta-based Intercontinental dropped \$12.05, or 11 percent, to \$98.03 today in New York Stock Exchange composite trading. CME Group of Chicago was down \$15.19, or 5.1 percent, at \$282.06 in Nasdaq Stock Market trading.

Trading Restrictions

Restrictions on trading energy futures could hurt commodities trading advisers, or CTAs, funds with about \$200 billion in assets.

CTAs posted gains of 13.5 percent in 2008, while hedge funds had an average loss of 22 percent, according to BarclayHedge, a Fairfield, Iowa-based fund tracker. CTAs fell 3.3 percent so far this year, according to the Barclays BTop50 Index of the largest funds.

'Most Liquid'

"Crude oil was one of the main trades for trend followers in 2008, that's where they made their money," said **Emanuel Balarie**, managing director of Chicago-based Balarie Capital Management. "They trade the most liquid markets they can, and crude oil futures are among the most liquid markets there are."

He called the CFTC proposal "pretty vague" and said "speculation is what makes markets efficient."

"If speculators leave the market, then the market is less liquid and you have weaker price discovery," Balarie said.

Crude oil for August delivery fell \$1.13, or 1.8 percent, to \$62.92 a barrel at the 2:30 p.m. close of floor trading on the New York Mercantile Exchange. Futures touched \$62.35, the lowest since May 27.

Regulation and oversight of deliverable futures contracts have always been necessary, said **Michael Cosgrove**, head of North American energy operations for broker GFI Group Inc. in New York.

"Oversight of contracts that do not affect supply and demand, such as Nymex cash-settled futures and ICE cash-settled swaps, is a misguided waste of taxpayer dollars," Cosgrove said today in an e-mail. "These contracts affect supply and demand no more than the betting at a race track affects the speed of the horses."

Postpone or Abandon

Energy producers may be forced to postpone or abandon some oil and natural-gas projects because the trading limits proposed by Gensler will constrain the ability of banks to act as counterparties in hedging deals, said **Paul Smith**, chief risk officer at Mobius Risk Group. Oil and gas companies routinely use forward contracts to lock in future revenue from production.

"This would be bullish for prices," Smith said in a telephone interview from Houston, where Mobius advises energy companies, utilities and buyout firms. "The bid-ask spread is going to widen and some people are going to be shut out of the market until the banks figure out how to handle this."

Smaller traders likely won't be affected by the changes, said **John Brady**, senior vice president at MF Global Inc., the world's largest broker of exchange-traded funds.

"The proposed regulations aren't going to matter materially for 90 percent of the floor and firms in Chicago," Brady said in an interview today. "Only the largest macro-funds would be affected."

Introduced Measures

Members of Congress, unable to get restrictions on speculation enacted last year, have introduced measures again this year to curb financial players in commodity markets.

Dorgan and Sanders had questioned President **Barack Obama's** choice of Gensler to lead the CFTC because of his involvement in legislation in 2000 that exempted certain derivatives trading from oversight.

Sanders has introduced legislation that would force the CFTC to invoke emergency authority to stop oil

speculation. Stupak's proposal, which was included as part of climate-change legislation approved by the House last month, would impose position limits on energy speculators across all markets.

Asset Bubble

The agency is seeking input on whether it should impose such aggregate position limits, Gensler said.

Gensler said in a letter to lawmakers earlier this year that speculators contributed to an asset bubble in commodities in 2008. His statement broke from former CFTC Acting Chairman **Walter Lukken**, who testified to Congress on Sept. 11 that there wasn't "strong evidence" index traders were driving up prices.

Gensler wouldn't say in the interview last week if he thought the same thing was happening this year.

"The CFTC currently sets and ensures adherence to position limits with respect to certain agriculture products," Gensler said in the statement. "For energy commodities, futures exchanges set position limits and accountability levels to protect against manipulation and congestion. The exchanges are not required to set and enforce position limits to prevent the burdens of excessive speculation."

Gensler said the CFTC is reviewing exemptions from position limits for "bona fide hedging," after seeking public comment on whether the exemption should continue to apply to traders who are in the market for financial reasons, rather than those that actually use the commodity.

The chairman also said the agency was going to improve its weekly commitment of traders' reports by separating out swaps dealers and hedge funds from the larger category of "commercial" traders. The agency will continue to collect and report data from swaps dealers and index investors, extending a "special call" from last year, Gensler said.

"Enhancing the quality of information in these weekly reports will better inform market participants and the public about the positions of the various types of traders," he said.

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