

CFTC's Plan To End Position Limits Saga Faces Big Test

By Tom Zanki

Law360 (February 5, 2020, 6:51 PM EST) -- The U.S. Commodity Futures Trading Commission's long-running effort to impose so-called position limits meant to curb speculators' ability to distort prices is moving closer to reality, though even proponents say the plan is flawed and needs fixing before it becomes final.

The CFTC's 3-2 vote last week to propose position limits on 25 physical commodity derivatives was pitched by Chairman Heath Tarbert as an overdue attempt to provide market participants with regulatory certainty. The proposal comes a decade after Congress passed the Dodd-Frank Act, which extended the watchdog's authority to set position limits following the financial crisis.

Tarbert, a Republican, cast a tie-breaking vote on the proposal, which moved forward along party lines. He has identified finalizing position limits rules as a priority since his testimony as the nominee for CFTC chairman before the Senate Agriculture Committee last March.

Adding urgency to the CFTC's efforts is the potential for the next Congress to reverse any regulations enacted after a certain point this year under the Congressional Review Act, which was invoked by Republicans in early 2017 to undo rules issued late in the administration of former President Barack Obama.

"I think this, of all the CFTC's agenda items, is the highest priority and I would not be surprised if the commission tries to move to a final rule as quickly as possible so as to minimize the potential overlap with the CRA period," said Steptoe & Johnson LLP partner Matthew Kulkin, a former director of the CFTC's Division of Swap Dealer and Intermediary Oversight.

The commission is accepting public comment on its proposal for 90 days through April 29, meaning it could take action on a final plan well before the November election.

The latest proposal marks the CFTC's fifth effort to put position limits to rest since the enactment of Dodd-Frank. The U.S. District Court for the District of Columbia in 2012 tossed a CFTC position limits rule that was challenged by Wall Street firms who said the law was vague. Additional proposals and re-proposals submitted from 2013 to 2016 were never finalized.

"In terms of whether a final rule gets passed this year, I think it certainly has potential because it's a

priority for the CFTC chairman,” Eversheds Sutherland counsel Ray Ramirez said. “But the commissioners themselves acknowledged that the proposal is not perfect.”

The CFTC’s Jan. 30 proposal is touted by Tarbert as flexible in how it sets limits and defers oversight — critics say too much — to commodity exchanges to enforce certain limits.

The plan would place limits on 25 futures contracts a trader could hold involving agricultural, metals and energy products ranging from coffee to gold to oil. Tarbert said the caps are intended to prevent a trader from cornering the market by amassing an outsize position.

The limits are set at 25% of the “deliverable supply” of the referenced commodity, though that cap is already well above limits set by various exchanges. CFTC Commissioner Dan Berkovitz, a Democrat who opposed the plan, cautioned that higher limits could enable “substantially more speculative positions” with potentially adverse results.

The CFTC’s proposal also expands the array of so-called bona fide hedging strategies, which provide an exemption from the limits for end-users of commodities, such as a farmer who needs relief for business needs, as opposed to a speculator who is betting on the commodity’s price. The CFTC’s inability to finalize bona fide hedge exemptions scuttled previous proposals.

Notably, the new plan allows users to seek exemptions not set forth in the rule proposal by applying directly to their relevant exchanges. Once the exchange approves it, the CFTC would have 10 days to review that decision or two days under narrow cases considered more urgent. This differs from current policy in which the CFTC has 30 days to review an exemption request.

Covington & Burling LLP counsel Anne Termine cited this proposed change as one of the rule’s more controversial elements.

“The streamlined process it provides to apply for additional bona fide hedge exemptions can be construed as the agency ceding too much authority to the exchanges,” said Termine, a former chief trial attorney in the CFTC’s enforcement division.

In fact, the CFTC’s two Democrats, Berkovitz and Rostin Benham, took issue with proposal’s plan to defer decisions on additional bona fide hedge exemptions to exchanges. Berkovitz said the plan was akin to demoting the CFTC from “head coach” to a “Monday-morning quarterback.”

Dawn Stump, a Republican commissioner who supported the proposal, also objected to its procedure for obtaining bona fide hedge exemptions not otherwise listed in the rule. She said giving the commission 10 days, or two days in some cases, to review an exchange’s decision to grant an exemption is “both too long and too short” in that a merchant may need relief sooner than those timelines, which at the same time deprive the agency the needed time for a meaningful review.

Stump said she would prefer that such decisions be the responsibility of the exchanges, which are already monitored by the CFTC through regular reviews. She also called on the public to improve this section of the proposal during the comment period.

Another sticking point for opponents is the proposal’s requirement that the commission must find that a position limit is necessary before it can be enacted, part of a long-simmering dispute over the wording of Dodd-Frank and its amendments to the Commodity Exchange Act.

The CFTC's General Counsel's Office interpreted the Commodity Exchange Act, which sets the ground rules for commodity regulation, as requiring the CFTC to impose position limits only when it finds them necessary. Berkovitz said this reasoning for the necessity requirement was unpersuasive, noting that Congress has found position limits to be an effective tool to prevent excessive speculation before it happens, and predicted the requirement would not survive judicial scrutiny.

In any event, the final rule proposal could differ from its current state given the various flashpoints. Termine said "it will be nearly impossible to balance all stakeholder interests" but noted that Tarbert is committed to getting the rule finalized and providing certainty to the market.

"The most important takeaway for the industry is to take advantage of the comment period and voice their concerns with the rule, as well as provide support for the portions of the rule that are liked," Termine said. "This kind of fulsome feedback is the only way the commission can attempt to draft and pass a final rule that may have lasting power."

--Editing by Marygrace Murphy.