

CRS Report for Congress

Speculation and Energy Prices: Legislative Responses

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Summary

While most observers recognize that the fundamentals of supply and demand have contributed to record energy prices in 2008, many also believe that the price of oil and other commodities includes a “speculative premium.” In other words, speculators who seek to profit by forecasting price trends are blamed for driving prices higher than is justified by fundamentals.

In theory, this should not happen. Speculation is not a new phenomenon in futures markets — the futures exchanges are essentially associations of professional speculators. There are two benefits that arise from speculation and distinguish it from mere gambling: first, speculators create a market where hedgers — producers or commercial users of commodities — can offset price risk. Hedgers can use the markets to lock in today’s price for transactions that will occur in the future, shielding their businesses from unfavorable price changes. Second, a competitive market where hedgers and speculators pool their information and trade on their expectations of future prices is the best available mechanism to determine prices that will clear markets and ensure efficient allocation of resources.

If one assumes that current prices are too high, that means that the market is not performing its price discovery function well. There are several possible explanations for why this might happen. First, there could be manipulation: are there traders in the market — oil companies or hedge funds, perhaps — with so much market power that they can dictate prices? The federal regulator, the Commodity Futures Trading Commission (CFTC), monitors markets and has not found evidence that anyone is manipulating prices. The CFTC has announced that investigations are in progress, but generally manipulations in commodities markets cause short-lived price spikes, not the kind of multi-year bull market that has been observed in oil prices since 2002.

Absent manipulation, the futures markets could set prices too high if a speculative bubble were underway, similar to what happened during the dot-com stock episode. If traders believe that the current price is too low, and take positions accordingly, the price will rise. Eventually, however, prices should return to fundamental values, perhaps with a sharp correction.

One area of concern is the increased participation in commodity markets of institutional investors, such as pension funds, foundations, and endowments. Many institutions have chosen to allocate a small part of their portfolio to commodities, often in the form of an investment or contract that tracks a published commodity price index, hoping to increase their returns and diversify portfolio risk. While these decisions may be rational from each individual institution’s perspective, the collective result is said to be an inflow of money out of proportion to the amounts traditionally traded in commodities, with the effect of driving prices artificially high.

This report provides basic information and analysis on the issue of commodity speculation and summarizes the numerous legislative proposals for controlling excessive speculation. It will be updated as events warrant.

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Speculation and Energy Prices: Legislative Responses

Overview

Are oil speculators the messengers bearing bad news, or are they themselves the bad news? The Commodity Futures Trading Commission (CFTC), which regulates speculative trading in energy commodities, has found no evidence that prices are not being set by the economic fundamentals of supply and demand. Many analysts agree, arguing that long-term supply growth will have difficulty keeping up with demand. Others, however, believe that changes in the fundamentals do not justify recent increases in energy prices, and seek the cause for soaring prices in the futures and derivatives markets, which are used by financial speculators as well as producers and commercial users of energy commodities.

The energy futures markets, which date from the 1980s, involve two kinds of traders. Hedgers — producers or commercial users of commodities — trade in futures to offset price risk. They can use the markets to lock in today's price for transactions that will occur in the future, shielding their businesses from unfavorable price changes.¹ Most trading, however, is done by speculators seeking to profit by forecasting price trends. Together, the trading decisions of hedgers and speculators determine commodity prices: there is no better mechanism available for determining prices that will clear markets and ensure efficient allocation of resources than a competitive market where hedgers and speculators pool information and trade on their expectations of future prices.

Since many transactions in the physical markets take place at prices generated by the futures markets, speculators clearly play a large part in setting energy prices. In theory, this should not drive prices away from the fundamental levels: if they trade on faulty assumptions about supply and demand, other traders with superior information — including those who deal in the physical commodities — should be able to profit at their expense. In other words, there is no reason why speculation in and of itself should cause prices to be artificially high.

Theory says increased speculation should produce more efficient pricing. In practice, some observers, including oil company CEOs, OPEC ministers, and investment bank analysts, now speak of a “speculative premium” in the price of oil. This view implies that without speculation, prices could fall significantly without disrupting current patterns of consumption and production. How could the price discovery function of the energy derivatives market have broken?

¹ See the **Appendix** for a description of the mechanics of a futures contract.

Several explanations are possible. First, the market could be manipulated. Price manipulation, which is illegal under the Commodity Exchange Act, involves deliberate strategies by a trader or group of traders to push prices to artificial levels. Since derivatives markets reward correct predictions about future prices, manipulation can be very profitable. Most manipulations in the past have involved short-lived price spikes, brought about by spreading false information, or concerted buying or selling. Since 2002, the CFTC has brought 40 enforcement cases involving manipulation, but these do not appear to explain the long-term energy price trends observed in recent years.

It is rare, but possible, for a market to be rigged over a longer period of time — examples include the Hunt brothers' attempt to corner the silver market in 1979-1980 and the manipulation of the copper market by Yasuo Hamanaka of Sumitomo in the mid-1990s — when a single trader or group amasses a dominant position in both physical supplies and futures contracts and obtains enough market power to dictate prices. The CFTC has not produced any evidence that such a grand-scale manipulation of energy prices is underway, and has testified repeatedly that prices are being set competitively.

In the absence of manipulation, another explanation for prices above fundamental levels is a speculative bubble. If, as was the case in the dot-com stock boom, a majority of traders become convinced that a “new era” of value has arrived, they may bid up prices sharply in defiance of counter-arguments based on fundamentals. Eventually, prices return to fundamental levels, often with a sudden plunge. This is what many forecast for energy prices, including George Soros, perhaps the best known speculator of the day.²

The bubble explanation is the same as the speculative premium argument. If market participants are trading on mistaken ideas about the fundamentals, they may set a price that is above the true price (which is the current market price minus the speculative premium). However, there is no sure method for determining what the true price is; the only observable price is the one the market generates.

Policy options to discourage speculation driven by irrational exuberance are limited.³ Actions to reduce the amount of speculative trading, such as increasing the margin requirements or restricting access to the markets, may not produce the desired outcome. Higher margins raise trading costs, which should reduce trading volumes, but the final effect on prices is uncertain. Empirical studies have not found a link between higher margins and lower price volatility, or any evidence that would suggest that prices would fall.⁴

² Soros, however, argues that an energy “bust” may be forestalled by new regulation on commodity index speculation by institutional investors. Testimony of George Soros before the Senate Commerce Committee, June 3, 2008, available at [http://commerce.senate.gov/public/_files/SorosFinalTestimony.pdf].

³ See CRS Report RL33666, *Asset Bubbles: Economic Effects and Policy Options for the Federal Reserve*, by Marc Labonte.

⁴ Some argue, in fact, that higher margins might actually drive prices higher, since many
(continued...)

Apart from the possibility that traders in general are getting the price wrong, there is an argument that prices have been driven up by a change in the composition of traders. In recent years, institutional investors — like pension funds, endowments, and foundations — have increasingly chosen to allocate part of their portfolios to commodities. This is rational from the point of view of the individual fund — it may increase investment returns and diversify portfolio risks — but when many institutions follow the same strategy at the same time, the effect can be that of a bubble. A number of bills are aimed at reducing the incidence or impact of institutional investment on the energy markets. These, and other proposals to improve the regulation of derivatives markets, are summarized below.

Legislative Proposals: Closing Loopholes

Legislative approaches to ensuring that commodity prices are not manipulated or distorted by excessive speculation focus on (1) extending regulatory control to previously unregulated markets, (2) ensuring that speculators cannot use foreign futures markets to avoid U.S. regulation, and (3) restraining the ability of institutional investors (and others who do not deal in the physical commodities themselves) to take large positions in commodities. These three areas are known respectively as the “Enron loophole,” the “London loophole,” and the “swaps loophole.”

The Enron Loophole

The “Enron loophole” refers to a range of transactions that occur off the regulated futures exchanges, in an “over-the-counter” (OTC) market where the CFTC has had little regulatory jurisdiction, and from which it does not receive comprehensive information about who is trading, in what volumes, and at what price.

The Commodity Futures Modernization Act (CFMA, P.L. 106-554) created a statutory exemption from CFTC regulation for certain contracts based on “exempt commodities,” defined in the legislation as commodities that are neither agricultural nor financial.⁵ Two types of energy derivative markets were thereby exempted: (1) bilateral, negotiated transactions between two counterparties that are not executed on a trading facility,⁶ and (2) trades done on an “electronic trading facility.” The CFMA specified that these markets must not be accessible to small investors; all traders must be “eligible contract participants” (financial institutions, units of government, or

⁴ (...continued)

long speculative positions are held by large institutional investors who would have no trouble meeting any margin demand.

⁵ See CRS Report RS21401, *Regulation of Energy Derivatives*, by Mark Jickling, for information on the CFMA.

⁶ The term “trading facility” is defined in the Commodity Exchange Act as a person or group of persons that constitutes, maintains, or provides a physical or electronic facility or system in which multiple participants have the ability to execute or trade agreements, contracts, or transactions by accepting bids and offers made by other participants that are open to multiple participants in the facility or system.

businesses or individuals with substantial financial assets) or, in the case of the electronic trading facility exemption, “eligible commercial entities” (eligible contract participants who either deal in the physical commodity or regularly provide risk management services to those who do).

A substantial volume of over-the-counter energy trading makes use of these exemptions. There is a large market in energy swaps, where investment banks like Goldman Sachs and Morgan Stanley offer contracts linked to energy prices. The OTC market in swaps has also evolved towards an exchange model, where contracts are traded rapidly over an electronic network, and may be backed by a clearing house. The best known of these electronic trading facilities is operated by Intercontinental Exchange Inc (ICE).⁷ The ICE over-the-counter market handles a volume of natural gas contracts roughly equal in size to that handled by Nymex, the largest energy futures exchange.

A Government Accountability Office report in October 2007 noted the growth of the OTC market and raised questions about whether the federal regulator had the information it needed to ensure that markets were free of fraud and manipulation.⁸ In the same month, the CFTC issued a report recommending legislative action to increase the transparency of energy markets.⁹

In May 2008, with the farm bill (H.R. 2419, P.L. 110-234), Congress passed legislation that generally follows the CFTC’s recommendations and potentially brings part of the OTC market under CFTC regulation. The new law affects electronic trading facilities handling contracts in exempt commodities (primarily energy or metals). If the CFTC determines that a contract traded on such a facility plays a significant price discovery role, that is, if the prices it generates are used as reference points for other transactions and markets, the facility will come under CFTC regulation. The market will have to register with the CFTC, and demonstrate its capacity to comply with several core principles. The principles and requirements include maintaining and enforcing rules against manipulation, establishing position limits or accountability levels to prevent excessive speculation, and providing the CFTC with daily reports on large traders’ positions.

The provisions of the Farm Bill, however, do not affect the unregulated status of energy contracts that are not entered into on a trading facility, in other words, the swap market in exempt commodities. Thus, the argument is made that the Enron loophole has been only partially closed. A number of bills propose to end the statutory exemption for OTC energy trades altogether, by putting energy commodities on the same regulatory basis as agricultural commodities. Under current law, derivative contracts based on farm commodities may only be traded on a regulated

⁷ ICE is a publicly traded firm, based in Atlanta, that also owns the largest regulated energy futures market in Europe, ICE Futures Europe (formerly the International Petroleum Exchange, located in London).

⁸ U.S. Government Accountability Office, *Trends in Energy Derivatives Markets Raise Questions about CFTC’s Oversight*, GAO 08-25, October 2007, 83 p.

⁹ U.S. Commodity Futures Trading Commission, *Report on the Oversight of Trading on Regulated Futures Exchanges and Exempt Commercial Markets*, October 2007, 23 p.

exchange, unless the CFTC issues an exemption.¹⁰ The CFTC is authorized to grant such exemptions on a case-by-case basis, after determining that the contract would not be against the public interest.

The London Loophole

Unlike the Enron loophole, which addresses the distinction between the regulated exchange markets and the unregulated OTC market, the “London loophole” refers to differences in the oversight of regulated markets in different countries. The U.K. counterpart to Nymex, the leading U.S. energy futures market, is ICE Futures Europe, which is regulated in the U.K. by the Financial Services Authority (FSA).

For several years, the U.K. exchange has been offering energy futures contracts in the United States, via electronic terminals. Ordinarily, an exchange offering futures contracts to U.S. investors is required to register with the CFTC as a “designated contract market,” and to comply with all applicable laws and regulations. However, in the case of ICE Futures Europe, the CFTC has waived that requirement, by means of a series of no-action letters, on the grounds that the U.K. market is already regulated at home, and that requiring it to register with the CFTC would be duplicative and add little in terms of market or customer protections.¹¹

Initially, the U.K. market offered electronic access to U.S. traders to its most popular contract, a futures contract based on the price of Brent Crude oil, produced in the North Sea. After the market was acquired by ICE, however, it introduced a “look-alike” contract that was identical to Nymex’s West Texas Intermediate crude oil future. This contract, which could be settled by making or taking delivery of physical crude oil in the United States, now trades in significant volumes — transactions that would presumably take place on the Nymex otherwise.¹²

With concern over high and volatile energy prices, there has been more scrutiny of ICE Futures Europe’s activities in the United States. Can traders avoid speculative position limits by trading on ICE, in addition to (or instead of) Nymex? Does the CFTC receive the same information from ICE Futures Europe about large trading positions that could be a source of manipulation or instability (if they were liquidated suddenly)?

A number of bills propose to close the London loophole, either by requiring foreign boards of trades (exchanges) to comply with all U.S. registration and regulatory requirements if they offer contracts that can be settled by physical delivery within the United States, or by making CFTC relief from such requirements and

¹⁰ Exemptive authority is provided by section 4(c) of the Commodity Exchange Act.

¹¹ The first no-action letter was issued in 1999, when the market was known as the International Petroleum Exchange. When the IPE was acquired by ICE (a U.S. firm), in 2001, the waiver continued, and was modified several times.

¹² In 2007, Nymex traded 121.5 million WTI futures contracts, while ICE Futures Europe traded 51.4 million. “Volume Surges Again,” *Futures Industry Magazine*, March/April 2008, p. 23.

regulation contingent upon a finding that (1) it will receive from the foreign market information that is comparable or identical to what it receives from domestic exchanges and (2) the foreign market is subject to a regulatory regime that is comparable to the CFTC's.

In the case of ICE Futures Europe, the CFTC announced that it had amended the "no-action relief letter" under which ICE Futures Europe is permitted direct access to U.S. customers. The amended letter conditions direct access on ICE Futures Europe's adoption of equivalent U.S. position limits and accountability levels on its West Texas Intermediate crude oil contract, which is linked to the New York Mercantile Exchange crude oil contract.¹³ This agreement complements a 2006 memorandum of understanding with the FSA providing for sharing of trading information.¹⁴

The CFTC's agreement with ICE appears to fulfill the purposes of several of the bills, but only with respect to the London market. The CFTC has issued other no-action letters granting regulatory waivers to foreign markets, including the Dubai Mercantile Exchange (a joint venture with Nymex), permitting it to offer contracts in the United States (to be cleared by Nymex). On July 7, 2008, the CFTC announced that it would modify the no-action letter to the Dubai exchange on terms similar to the agreement with ICE Futures Europe.¹⁵

The Swaps Loophole

The view that excessive speculation is driving up energy prices is widely held, but controversial. The question of whether current prices are justified by fundamental factors of supply and demand, or whether irrational exuberance has created a bubble in energy prices (similar to what was observed in dot-com stocks in the late 1990s), is beyond the scope of this report. However, testimony presented to Congress has identified a recent trend in financial markets that some argue may be putting upward pressure on prices — decisions by institutional investors, such as pension funds, foundations, or endowments, to allocate a part of their portfolio to commodities.¹⁶

¹³ U.S. Commodity Futures Trading Commission, "CFTC Conditions Foreign Access on Adoption of Position Limits on London Crude Oil Contract," Release 5511-08, June 17, 2008.

¹⁴ Online at [<http://www.cftc.gov/newsroom/generalpressreleases/2006/pr5259-06.html>].

¹⁵ U.S. Commodity Futures Trading Commission, "CFTC Grants Relief to NYMEX in Connection with Clearing Contracts Traded on the Dubai Mercantile Exchange DME Trading System to be Available in U.S.," Release 5339-07, May 25, 2007; and "CFTC Grants Exemption to NYMEX in Connection with Three New Contracts to be Traded on the Dubai Mercantile Exchange," Release 5495-08, May 1, 2008.

¹⁶ Testimony of Michael W. Masters before the Senate Committee on Homeland Security and Governmental Affairs, May 20, 2008, available at [http://hsgac.senate.gov/public/_files/052008Masters.pdf].

From the point of view of a fund manager, investment in commodities may be very attractive under current market conditions. Average returns on stocks and bonds have been relatively low for the past few years, and there is little optimism that they will improve in the near term. Commodities, on the other hand have been the “hot sector.” While commodity investment is recognized as being highly risky, a risky asset in a large, diversified portfolio does not necessarily increase overall portfolio risk. The risk of a downturn in commodity prices is not generally correlated with risks in stocks or bonds; in some cases, there may be an inverse relationship. For example, if the price of oil drops suddenly, the institution may lose money on its commodity investment, but the price change will be good for its transportation stocks.

Institutional investors may take positions in commodities in a number of ways, but they do not generally trade on the futures exchanges directly. Instead, they use an intermediary, such as a commodity index fund or an OTC swap contract that is structured to match the return of a published index of commodity prices.¹⁷ As a result of this investment strategy, institutional investors in commodities are often called “index traders.”

While the decision of an individual pension fund to put 3%-4% of its portfolio in commodities may appear entirely rational, some observers argue that the aggregate impact of institutional index trading has been to overwhelm the commodity markets, because of the disproportion between the amount of money held by pension funds and others and the amounts that have traditionally been traded in the energy futures market. In other words, index investing is seen as excessive speculation. One particular feature of index trading is the focus of several legislative proposals: the “swaps loophole.”

The CFTC and the exchanges maintain position limits or accountability levels that apply to speculative traders. Speculators either face a ceiling on the number of contracts they may own, or, if they breach a position accountability level, they must explain to the exchange why they are accumulating such a large position. The purpose of the speculative limits is to prevent manipulation by speculators with very large positions, and to limit the market impact in cases where losses force speculators to liquidate their positions suddenly.

Position limits do not apply to hedgers, those who use the futures markets to offset price risk arising from their dealings in the underlying commodity. Hedgers are allowed to take positions commensurate with their commercial interests. The rationale for exempting them from position limits is that when they have a hedged position, they have no incentive to manipulate the market: any gains in their futures position will be offset by losses in their physical transactions, and vice versa. (They

¹⁷ Examples of such indices are the Dow Jones-AIG Commodity Index, or the Goldman Sachs Commodity Index, which are variously weighted among farm products, energy commodities, and metals. A swap contract is a derivative economically equivalent to a futures contract: two parties agree to exchange payments over the life of a contract that are linked to a price, index, or other variable. Depending on which way the underlying variable moves, the cash flows will be net positive for one counterparty, and negative for the other.

use the futures markets to lock in today's price, meaning that subsequent price changes do not affect them.)

Traditionally, hedgers have been thought of as those who are active in the physical commodity markets — in the energy market, these would be oil producers, refiners, transporters, and industrial users such as airlines and utilities. With the rise of index trading, however, the definition of hedger has broadened. Both the CFTC and Nymex now extend exemptions from speculative position limits to swaps dealers who are using the futures exchanges to hedge price risk arising from a financial contract with an institutional investor.

In other words, a pension fund wishing to invest in commodities may go to a swap dealer¹⁸ and enter into a contract that will pay returns equal to the percentage increase in an index of commodity prices. In economic terms, this is equivalent to a long position in futures, which will gain value if the underlying commodity price rises. The swap dealer has, in effect, taken the short side of the trade: it will lose money if prices rise.

The swap dealer is exposed to price risk, and may wish to offset that risk by purchasing exchange-traded futures contracts. Because the dealer is using the futures market to hedge the risk of the swap, the exchanges and the CFTC exempt it from position limits, even though it does not deal in the physical commodity. The rationale is the same as for traditional hedgers: since the swap dealer will gain on its futures position whatever it loses on the swap, and vice versa, it has no incentive to manipulate futures prices.

The effect of this “swaps loophole,” however, is to let the ultimate customer — the institutional investors who are clearly speculating on commodity prices — to take larger positions than they would be able to do if they traded directly on the futures exchanges, where they might be constrained by speculative position limits. Hence the description of institutional investors' index trading as excessive speculation.

A number of bills propose to constrain the ability of institutional investors to use the swaps loophole. They would limit the definition of “bona fide hedger” to those who deal in the physical commodity or prohibit trading in OTC energy contracts by those who do not deal in the physical commodity.

Other Legislative Approaches

Raising Margins. Three bills (H.R. 2991, S. 3044, and S. 3183) call for the CFTC to raise margins on oil futures. The margin requirement is the minimum amount of money per futures contract that traders must deposit with their brokers. Margin requirements are set by the exchanges, and are intended to cover losses. At the end of each day, the exchange credits or debits every trader's margin account with the amount of gains or losses. Traders whose margin accounts fall below the

¹⁸ The major swap dealers in energy markets are investment banks like Goldman Sachs and Morgan Stanley.

minimum requirement will be required to post additional margin before the market opens next day, or their positions may be closed out at a loss.

The exchanges tend to raise margins during periods of price volatility, when the probability of large price swings increases the risk of loss. Nymex has raised the initial margin requirement for crude oil futures contracts (each of which represents 1,000 barrels of oil) several times in 2008.¹⁹

Since everyone in futures markets trades on margin,²⁰ raising margins means higher trading costs, which should cause some traders to reduce the size of their positions and reduce trading volume overall. However, as noted above, there is no empirical evidence that higher margins dampen price volatility, making the effect on price uncertain.

Increasing CFTC Resources. Several bills (H.R. 6334, H.R. 6349, and S. 3202) call for supplemental appropriations to permit the CFTC to hire 100 new employees to monitor the energy markets.

Emergency Actions. H.R. 6377, passed by the House on June 26, 2008, and S. 3205 direct the CFTC to use its existing powers, including its emergency authority, to curb immediately the role of excessive speculation in energy and to eliminate price distortion, unreasonable or unwarranted price fluctuations, or any unlawful activities that prevent the market from accurately reflecting the forces of supply and demand for energy. (CFTC's emergency authority includes the power to set margin levels or to order the liquidation of trading positions.)

Studies of the Market. A number of bills call for studies of various aspects of the market, including the effects of raising margin, the adequacy of international regulation, the effects of speculation, and the impact of index trading on prices.

Table 1 below provides summaries of all legislation that bears on the regulation of energy speculation.

¹⁹ At the beginning of 2008, the crude oil margin requirement was \$6,075; on July 1, 2008, it was raised to \$12,488. (Both figures are for customers; margin requirements for exchange members are slightly lower.)

²⁰ This is unlike the stock market, where margin refers to loans extended to buy stock (and collateralized by the purchased securities). Relatively few stock purchases are made on margin.

Table 1. Summaries of Energy Futures and Speculation Bills

Bill Number /Sponsor	Status	Summary
H.Res. 1278 (Rep. Petri)	Referred to the Committee on Foreign Affairs	Expresses the sense of the House that the United States should lead an international diplomatic initiative to limit inefficient speculation on international energy exchanges through the adoption of international standards for energy futures trading margin requirements as an appropriate means of ensuring access to reliable and affordable supplies of crude oil.
H.Res. 1289 (Rep. Shays)	Referred to the House Committee on Agriculture	Urges the CFTC to require institutional investors to abide by position limits already established for the greater crude oil trading community, and urges the President to direct the CFTC to work with the United Kingdom Financial Services Authority to establish position limits on oil futures traded on the Intercontinental Exchange that are similar to those that apply to traders on the New York Mercantile Exchange.
H.R. 594 (Rep. Stupak)	Referred to House Subcommittee on General Farm Commodities and Risk Management	Prevent Unfair Manipulation of Prices Act of 2007. Creates a new regulatory category, “included energy transactions,” encompassing over-the-counter transactions in energy derivatives that play a significant role in determining prices paid in the cash market for the underlying commodities. Sets forth reporting and recordkeeping requirements for included energy transactions, requiring that certain information about price and trading volumes (as well as other information the CFTC needs to prevent and detect price manipulation) be made available to regulators and/or the public. Clarifies prohibitions against commodity fraud and manipulation, and increases civil and criminal penalties for violations.

Bill Number /Sponsor	Status	Summary
H.R. 2419 (Rep. Peterson)	P.L. 110-234 enacted May 22, 2008, over the President's veto	<p>Food Conservation and Energy Act of 2008 (the Farm Bill). Title XIII included provisions reauthorizing the CFTC and creates a new regulatory regime for certain OTC energy derivatives markets, subjecting them to a number of exchange-like regulations. The provisions apply to “electronic trading facilities” — markets where multiple buyers and sellers are able to post orders and execute transactions over an electronic network. If the CFTC determines that a contract traded on these markets, previously exempt from most regulation, plays a significant role in setting the price of the underlying commodity, they will be required to register with the CFTC and comply with several regulatory core principles aimed at curbing manipulation and excessive speculation (including the establishment and enforcement of position limits). They will be required to publish and/or report to the CFTC information relating to prices, trading volume, and size of positions held by speculators and hedgers.</p> <p>These new regulatory requirements apply only to electronic markets that have come to resemble the regulated futures exchanges. Bilateral OTC derivative contracts between two principals (e.g., between a swap dealer and an institutional investor), that are not executed on a trading facility where multiple bids and offers are displayed, will continue to be largely exempt from CFTC regulation.</p>
H.R. 3009 (Rep. Barrow)	Referred to House Subcommittee on General Farm Commodities and Risk Management	Market Transparency Reporting of United States Transactions Act of 2007. Imposes reporting requirements on OTC contracts in natural gas. The information to be disclosed shall be sufficient to enable the CFTC to assess the overall trading activities, potential market power, and concentration of positions held by the largest traders. The CFTC shall publish a report setting out the information received, in aggregate form.

Bill Number /Sponsor	Status	Summary
H.R. 4066 (Rep. Welch)	Referred to House Committee on Agriculture	<p>Close the Enron Loophole Act. Defines a new regulated entity — “energy trading facility” — an OTC market that plays a significant role in price discovery. Requires energy trading facilities (ETFs) to register with the CFTC, and sets out criteria for registration, including the capacity to monitor trading to prevent manipulation and excessive speculation. ETFs must also establish and enforce speculative position limits that are comparable to the limits that apply to regulated futures exchanges, and must publish data on trading volumes and prices.</p> <p>Also imposes reporting and recordkeeping requirements on transactions on foreign futures exchanges that involve delivery of energy commodities within the United States, where such transactions are executed on terminals located in the U.S.</p>
H.R. 6130 (Rep. Barton)	Referred to the Committee on Agriculture, and in addition to the Committee on Energy and Commerce	<p>Calls for an interagency study of the effects of speculation in the futures markets (including foreign futures markets) for natural gas, crude oil, and gasoline on cash market and retail prices for the commodities.</p> <p>Directs the CFTC to issue a regulation setting out how it determines whether futures and derivatives regulation in a foreign country is comparable to U.S. regulation of those markets.</p>
H.R. 6238 (Rep. Dingell)	Referred to the House Committee on Energy and Commerce	<p>Directs the Secretary of Energy to establish an interagency working group to study the impact of market speculation and manipulation on the price of crude oil and refined petroleum products and the international regulation of trading markets. The working group shall issue a report within one year, and shall make recommendations for legislative or regulatory action at any time if needed to protect U.S. energy consumers from the potential for abuse and manipulation by activities taking place in energy markets or exchanges.</p>

Bill Number /Sponsor	Status	Summary
H.R. 6264 (Rep. Larson)	Referred to the House Committee on Agriculture	Limits over-the-counter derivative transactions in energy commodities (defined as crude oil, heating oil, gasoline, or diesel fuel) to persons whom the CFTC has certified as having the capacity to produce, manufacture, or accept physical delivery of the commodity.
H.R. 6279 (Rep. Chabot)	Referred to the House Committee on Agriculture	<p>Oil Speculation Reduction Act of 2008. Prohibits the CFTC from exempting from U.S. regulation a foreign board of trade that offers contracts in crude oil to be physically delivered in the United States, unless (1) the foreign market applies principles or requirements daily publication of trading information and position limits or accountability levels for speculators that are comparable to those applied by U.S. exchanges, (2) provides the CFTC with information about large trading positions comparable to what the CFTC receives from U.S. markets, and (3) imposes margin requirements that are comparable to those in U.S. markets and sufficient to reduce excessive speculation and protect consumers.</p> <p>CFTC shall, within 18 months of enactment, review waivers of regulation already extended to foreign exchanges, and shall report to Congress within 12 months on the implementation of this act.</p>

Bill Number /Sponsor	Status	Summary
H.R. 6284 (Rep. Matheson)	Referred to the House Committee on Agriculture	<p>Authorizes the CFTC to apply anti-manipulation and certain other provisions of the Commodity Exchange Act to persons located in the United States trading on foreign futures exchanges, and to require such person to limit, reduce, or liquidate any position to prevent or reduce the threat of price manipulation, excessive speculation, price distortion, or disruption of delivery or the cash settlement process.</p> <p>Limits the CFTC's authority to exempt foreign futures markets that offer contracts based on "an energy commodity that is physically delivered in the United States" from U.S. regulation. Before granting such relief from regulation, CFTC must determine that the foreign market applies principles regarding the publication of trading information and position limits or accountability levels for speculators that are comparable to U.S. law and regulation, and that the CFTC receives from the foreign market the same information regarding large trader positions that it receives from U.S. exchanges. Requires the CFTC to reevaluate within 18 months any foreign markets to which it has previously granted relief from U.S. registration requirements.</p>

Bill Number /Sponsor	Status	Summary
<p>H.R. 6330 (Rep. Stupak)</p>	<p>Referred to the Committee on Agriculture, and to the Committee on Energy and Commerce</p>	<p>Prevent Unfair Manipulation of Prices Act of 2008. Specifies that “energy commodities” (as defined) are not exempt commodities. As a result, trading in OTC contracts in energy commodities would not be exempted from regulation by statute, but would require CFTC approval on a case-by-case basis, which could be granted only after 60-day notification to Congress and a public comment period. Bilateral OTC energy contracts (not executed on a trading facility) would be subject to reporting and recordkeeping requirements.</p> <p>Foreign futures markets offering contracts in the United States, with a delivery point in the United States, would be subject to U.S. regulation.</p> <p>The definition of “bona fide hedger” would exclude those hedging price risk arising from energy swaps. The CFTC would be required to publish certain information about trading strategies that track commodity price indexes, including the size of positions and the total value of index speculation.</p> <p>Provides FERC with cease-and-desist authority to freeze the assets of companies prosecuted under its anti-manipulation authority.</p>

Bill Number /Sponsor	Status	Summary
H.R. 6334 (Rep. Etheridge)	Referred to the House Committee on Agriculture	<p>Expresses the sense of the House that the President should request emergency appropriations for the CFTC in FY2008, in order to hire 100 additional employees to monitor and improve enforcement in energy markets.</p> <p>Directs the CFTC, before granting relief from U.S. registration and regulatory requirements to any foreign market offering contracts involving delivery of energy commodities in the United States, to determine that the foreign market applies regulations regarding publication of trading data and position limits that are comparable to U.S. regulations, and that the foreign market supplies the CFTC with the same type of information about large speculative and hedging positions that the CFTC now obtains from U.S. exchanges.</p> <p>Directs the CFTC to publish monthly data on the positions of index funds (and other passive, long-only positions) in energy markets, including the total amount of such investments and the size of speculative positions compared to those of hedgers who deal in the physical commodities.</p>
H.R. 6341 (Rep. Van Hollen)	Referred to the House Committee on Agriculture	<p>Energy Markets Anti-Manipulation and Integrity Restoration Act . Removes “energy commodities” (as defined) from the category of exempt commodities, thus ending the statutory exemption from CFTC regulation for OTC energy contracts.</p> <p>Specifies that a board of trade, exchange, or market shall not be considered to be foreign if it has a trading affiliate or trading infrastructure located in the United States; and a contract of sale of an energy commodity for future delivery in the United States, which is a significant price discovery contract (as determined by the CFTC) for the energy commodity, is executed or traded on or through the board of trade, exchange, or market.</p>

Bill Number /Sponsor	Status	Summary
H.R. 6349 (Rep. J. Marshall)	Referred to the House Committee on Agriculture	<p>Increasing Transparency and Accountability in Oil Prices Act of 2008. Expresses the sense of the House that the President should request emergency appropriations for the CFTC, to fund 100 new positions to oversee energy futures market speculation and help restore public confidence. Establishes the Office of Inspector General as an independent office within the CFTC.</p> <p>Calls for a GAO study of international regulation of energy derivatives.</p> <p>Limits the CFTC’s authority to exempt foreign futures markets that offer contracts based on “an energy commodity that is physically delivered in the United States” from U.S. regulation. Before granting such relief from regulation, CFTC must determine that the foreign market applies principles regarding the publication of trading information and position limits or accountability levels for speculators that are comparable to U.S. law and regulation, and that the CFTC receives from the foreign market the same information regarding large trader positions that it receives from U.S. exchanges. Requires the CFTC to reevaluate within 18 months any foreign markets to which it has previously granted relief from U.S. registration requirements. Expands CFTC jurisdiction over certain trades by U.S. persons executed on foreign markets.</p> <p>Directs the CFTC to require detailed reporting from swaps dealers and index traders, and to review index trading to ensure that it does not adversely impact the price discovery process. Requires the CFTC to publish monthly data on the number and total of index funds and data on speculative positions relative to bona fide physical hedger positions.</p>

Bill Number /Sponsor	Status	Summary
H.R. 6372 (Rep. Hill)	Referred to the House Committee on Agriculture	<p>Commodity Futures Restoration Act. Removes energy commodities (as defined) from the class of exempt commodities. Puts energy swaps on the same regulatory basis as agricultural commodity swaps.</p> <p>A futures exchange shall not be considered foreign if (1) it has an affiliate located in the United States, (2) it trades a contract settled by delivery in the United States, or (3) it trades a significant price discovery contract.</p> <p>Exemptions from position limits for bona fide hedgers shall not apply to swaps involving energy commodities.</p> <p>Directs the CFTC to report to Congress within 90 days of enactment on margin levels and position limits applicable to energy commodities.</p>
H.R. 6377 (Rep. Peterson)	Passed the House, June 26, 2008	<p>Energy Markets Emergency Act of 2008. Directs the CFTC to utilize all its authority, including its emergency powers, to:</p> <p>(1) curb immediately the role of excessive speculation in any contract market within the jurisdiction and control of the Commodity Futures Trading Commission, on or through which energy futures or swaps are traded; and</p> <p>(2) eliminate excessive speculation, price distortion, sudden or unreasonable fluctuations or unwarranted changes in prices, or other unlawful activity that is causing major market disturbances that prevent the market from accurately reflecting the forces of supply and demand for energy commodities.</p>

Bill Number /Sponsor	Status	Summary
S. 577 (Sen. Feinstein)	Referred to the Senate Committee on Agriculture, Nutrition, and Forestry	<p>Oil and Gas Traders Oversight Act of 2007. Amends the Commodity Exchange Act to prescribe reporting and recordkeeping requirements for positions involving energy commodities (a commodity or the derivatives of a commodity used primarily as a source of energy).</p> <p>Directs the Commodity Futures Trading Commission to subject to the requirements of this Act a contract, agreement, or transaction for future delivery in an energy commodity.</p>
S. 2058 (Sen. Levin)	Referred to the Senate Committee on Agriculture, Nutrition, and Forestry	<p>Close the Enron Loophole Act. Defines a new regulated entity — “energy trading facility” — an OTC market that plays a significant role in price discovery. Requires energy trading facilities (ETFs) to register with the CFTC, and sets out criteria for registration, including the capacity to monitor trading to prevent manipulation and excessive speculation. ETFs must also establish and enforce speculative position limits that are comparable to the limits that apply to regulated futures exchanges, and must publish data on trading volumes and prices.</p> <p>Also imposes reporting and recordkeeping requirements on transactions on foreign futures exchanges that involve delivery of energy commodities within the United States, where such transactions are executed on terminals located in the U.S.</p>

Bill Number /Sponsor	Status	Summary
S. 2991 (Sen. Reid)	Placed on Senate Legislative Calendar under General Orders	<p>Consumer-First Energy Act of 2008 - Sec. 501 limits the CFTC's authority to exempt foreign futures markets that offer contracts based on "an energy commodity that is physically delivered in the United States" from U.S. regulation. Before granting such relief from regulation, CFTC must determine that the foreign market applies principles regarding the publication of trading information and position limits or accountability levels for speculators that are comparable to U.S. law and regulation, and that the CFTC receives from the foreign market the same information regarding large trader positions that it receives from U.S. exchanges. Requires the CFTC to reevaluate any foreign markets to which it has previously granted relief from U.S. registration requirements.</p> <p>Sec. 502 directs the CFTC to issue within 90 days of enactment regulations setting "a substantial increase in margin levels for crude oil traded on any trading facility" under CFTC's jurisdiction. Calls for CFTC and GAO to conduct separate studies on the impact of increases in margin requirements.</p>
S. 2995 (Sen. Levin)	Referred to the Committee on Agriculture, Nutrition, and Forestry	<p>Oil Trading Transparency Act. Limits the CFTC's authority to exempt foreign futures markets that offer contracts based on "an energy commodity that is physically delivered in the United States" from U.S. regulation. Before granting such relief from regulation, CFTC must determine that the foreign market applies principles regarding position limits or accountability levels for speculators and publication of trading information that are comparable to U.S. law and regulation, and that the CFTC receives from the foreign market the same information regarding large trader positions that it receives from U.S. exchanges. Requires the CFTC to reevaluate any foreign markets to which it has previously granted relief from U.S. registration requirements.</p>
S. 3044 (Sen. Reid)	Motion to proceed to measure considered in Senate	<p>Consumer-First Energy Act of 2008. Includes provisions related to foreign futures markets and an increase in oil futures margins identical to S. 2991.</p>

Bill Number /Sponsor	Status	Summary
S. 3081 (Sen. Kerry)	Referred to the Committee on the Judiciary	Establishes a Petroleum Industry Antitrust Task Force within the Department of Justice to examine, among other issues, the existence and effects of any anticompetitive manipulation in futures markets or other trading exchanges relating to petroleum or petroleum products.
S. 3122 (Sen. Cantwell)	Referred to the Senate Committee on Agriculture, Nutrition, and Forestry	Policing United States Oil Commodities Markets Act of 2008. Requires foreign markets “that operate trading terminals in the United States, on which are traded contracts that serve a price discovery function for any energy commodity that is delivered in the United States” to register with the CFTC as designated contract markets (or regulated exchanges). Also applies to markets to which CFTC has already granted relief from registration requirements.
S. 3129 (Sen. Levin et al.)	Referred to the Committee on Agriculture, Nutrition, and Forestry	<p>Close the London Loophole Act of 2008. Authorizes the CFTC to apply anti-manipulation and certain other provisions of the Commodity Exchange Act to persons located in the United States trading on foreign futures exchanges, and to require such person to limit, reduce, or liquidate any position to prevent or reduce the threat of price manipulation, excessive speculation, price distortion, or disruption of delivery or the cash settlement process.</p> <p>Limits the CFTC’s authority to exempt foreign futures markets that offer contracts based on “an energy commodity that is physically delivered in the United States” from U.S. regulation. Before granting such relief from regulation, CFTC must determine that the foreign market applies principles regarding the publication of trading information and position limits or accountability levels for speculators that are comparable to U.S. law and regulation, and that the CFTC receives from the foreign market the same information regarding large trader positions that it receives from U.S. exchanges. Requires the CFTC to reevaluate within 18 months any foreign markets to which it has previously granted relief from U.S. registration requirements.</p>

Bill Number /Sponsor	Status	Summary
S. 3130 (Sen. Durbin)	Referred to the Committee on Agriculture, Nutrition, and Forestry	<p>Increasing Transparency and Accountability in Oil Prices Act. Expresses the sense of the Senate favoring a supplemental appropriation to increase the CFTC’s resources, including the hiring of 100 new employees to monitor energy futures markets. Establishes the Office of Inspector general as an independent office within the CFTC. Directs GAO to study the international regime for regulating the trading of energy commodity futures and derivatives.</p> <p>Includes provisions related to foreign futures markets identical to S. 2991.</p>
S. 3131 (Sens. Feinstein and Stevens)	Referred to the Senate Committee on Agriculture, Nutrition, and Forestry	<p>Oil Speculation Control Act of 2008. Makes institutional investors who trade in energy contracts but do not take or make physical delivery of energy commodities subject to speculative position limits or accountability levels. Defines “bona fide hedging transactions” as those related to price risk arising from physical energy transactions.</p> <p>Establishes the Office of Inspector general as an independent office within the CFTC.</p> <p>Extends large trader reporting requirements to index traders, swap dealers, and institutional investors. Directs the CFTC to review the trading practices of index traders, swap dealers, and institutional investors in markets under CFTC jurisdiction to ensure that such practices are not impeding the price discovery process, to gather information, and to assess the adequacy of current regulation of such trading practices.</p> <p>Directs the CFTC to use its emergency authority to impose a 60-day freeze to prevent institutional investors from increasing the size of their positions in energy commodity futures or commodity future index funds.</p>

Bill Number /Sponsor	Status	Summary
S. 3134 (Sen. B. Nelson)	Referred to the Committee on Agriculture, Nutrition, and Forestry	Removes energy commodities (as defined) from the class of exempt commodities. Transactions in energy commodities will be subject to the same degree of regulation under the Commodity Exchange Act as agricultural commodities. That is, there will no longer be a statutory exemption for OTC energy trades.
S. 3183 (Sen. Dorgan)	Referred to the Committee on Agriculture, Nutrition, and Forestry	<p>Directs the CFTC to use its authority to eliminate manipulation and speculation from the petroleum futures market. Requires the CFTC to distinguish between “legitimate hedge trading” — transactions involving commercial producers and consumers of physical petroleum products — and all other trades.</p> <p>Requires the CFTC to revoke or modify all prior actions or decisions, (including exemptions from position limits for trading other than legitimate hedge trading) that prevent the CFTC from protecting legitimate hedge trades and discouraging speculative trades.</p> <p>Requires the CFTC to order an increase in petroleum futures margin requirements to at least 25% for trades not classified as legitimate hedge trading.</p> <p>Requires the CFTC to convene an international working group of regulators to ensure the protection of petroleum futures market from excessive speculation and world wide forum shopping.</p>
S. 3185 (Sen. Cantwell)	Referred to the Committee on Agriculture, Nutrition, and Forestry	Identical to H.R. 6330.

Bill Number /Sponsor	Status	Summary
S. 3202 (Sen. McConnell)	Placed on Senate Legislative Calendar under General Orders. Calendar No. 854	<p>Gas Price Reduction Act of 2008. (Title IV — Energy Commodity Markets.) Directs the President’s Working Group on Financial Markets to study the international regulation of energy derivatives.</p> <p>Bars the CFTC from permitting direct access by U.S. investors to foreign futures markets trading contracts that settle on prices of U.S. contracts, unless those markets (1) publish trading data comparable to U.S. futures exchanges, (2) adopt position limits comparable to U.S. limits, and (3) provide the CFTC with large trader reports comparable to what the CFTC receives from U.S. markets.</p> <p>Directs the CFTC to set reporting requirements for swap dealers and index traders, and to publish monthly aggregate figures on index investing and other passive, long-only strategies in energy and agricultural commodities.</p> <p>Directs the CFTC to hire 100 new employees for monitoring and enforcement in energy markets, and authorizes appropriations for this purpose.</p>
S. 3205 (Sen. Cantwell)	Referred to the Committee on Agriculture, Nutrition, and Forestry	A bill to direct the Commodity Futures Trading Commission to utilize all its authority, including its emergency powers, to curb immediately the role of excessive speculation in any contract market within the jurisdiction and control of the Commodity Futures Trading Commission, on or through which energy futures or swaps are traded, and to eliminate excessive speculation, price distortion, sudden or unreasonable fluctuations or unwarranted changes in prices, or other unlawful activity that is causing major market disturbances that prevent the market from accurately reflecting the forces of supply and demand for energy commodities.

Appendix. Mechanics of Futures Contracts

The Mechanics of a Futures Contract

An oil futures contract represents 1,000 barrels of oil, but neither party to the contract need ever possess the actual commodity. (Contracts may be settled by physical delivery, but in practice the vast majority are settled in cash.) When a contract is made today, one party (called the “long”) agrees to buy oil at a future date from the other (the “short”). Contracts are available with different maturities, designated by expiration months, but the size is always the same. (In oil, there is a contract expiring every month.) The price at which this future transaction is to take place is the current market price. Assuming the price of oil is \$135 per barrel, the long trader is committed to buy at that price, and the short is obliged to sell.

Assume that tomorrow the price of oil goes to \$140/barrel. The long trader now has the advantage: he is entitled to buy for \$135 oil that is now worth \$140. His profit is \$5,000 (the \$5 per barrel increase times the 1,000 barrels specified in the contract). The short has lost the identical amount: she is obliged to sell oil for less than the going price.

If, on the following day, the price goes to \$145, the long gains another \$5,000. The short, down a total of \$10,000, may reconsider her investment strategy and decide to exit the market. She can do this at any time by entering into an offsetting, or opposite transaction. That is, she purchases a long contract with the same expiration date. Her obligation (on paper) is now to sell 1,000 barrels (according to the first contract) and to buy 1,000 barrels (the second contract) when both contracts expire simultaneously. Whatever price prevails at that time, the net effect of the two transaction will be zero. The short’s position is said to be “evened out” — she is out of the market.

The short’s decision to exit does not affect the long, who may prefer to ride with the trend. This is because all contracts are assumed by the exchange’s clearing house, which becomes the opposite party on each trade, and guarantees payment. The ability to enter and exit the market by offset, without having to make or take delivery of the physical commodity, permits trading strategies based on short-term price expectations. While some traders may keep a long or short position open for weeks or months, others buy and sell within a time frame of minutes or seconds.

The exchange clearing house, which guarantees all trades, also controls traders’ funds. Before entering into the trade described above, both long and short would have been required to deposit an initial margin payment of \$11,813. (The amount is set by the exchange; the figure is current as of June 30, 2008.) All contracts are priced, or “marked-to-market,” each day. The long trader above would have had his \$10,000 gain credited to his margin account, while the short would have had to make additional “maintenance” margin payments to cover her losses. It is worth noting that her two-day \$10,000 loss represents 85% of her original investment, that is, her initial margin deposit of \$11,813: the risks of futures speculation are high. When traders exit the market, any funds remaining in their margin accounts are returned. (Other transaction costs, such as brokerage commissions and exchange fees, are not returnable.)

Options on futures are also available for many futures contracts. The holder of an option has the right (but not the obligation) to enter into a long or short futures contract over the life of the option. The option will only be exercised if price movements are favorable to the option buyer, that is, if the underlying futures contract would be profitable. The seller of the option receives a payment (called a premium) for granting this right. The seller profits if the option is not exercised by the buyer.