<u>Imposing Aggregate Speculative Position Limits</u>
Proposal #2
June 18, 2008

<u>Background</u>: The 1936 Commodity Exchange Act recognizes that excessive speculation in commodity futures markets can cause sudden or unreasonable fluctuations or unwarranted changes in commodity prices. The Act also notes that such speculation presents an undue and unnecessary burden on interstate commerce. To diminish the burden created by excessive speculation, the law directs the Commodity Futures Trading Commission (CFTC) to create limits on futures positions that may be held by any person. These restrictions are generally set by the exchanges themselves, take the form of speculative position limits, and apply to individual investors.

Although the individual position limits can play an important role in reducing excessive speculation in commodity markets, the total number of commodity investors has dramatically increased in the last few years. Some commentators have suggested that the influx of new investors is driving commodity markets to a tipping point where financial speculators are overwhelming physical traders. These financial speculators have no intention of taking physical delivery of the underlying commodity. But there is compelling evidence that their financial speculation, in addition to market fundamentals, is a factor in the higher costs at the pump and in the grocery store.

<u>Proposal</u>: Some experts have proposed creating aggregate limits on the share of the commodity futures market that may be held by financial investors. The proposal would:

- Amend the Commodity Exchange Act to clarify that excessive speculation that causes price inflation beyond levels justified by the market fundamentals underlying the supply and demand for physical commodities is an undue and unnecessary burden and should be addressed by the CFTC.

- Direct the Commission to establish aggregate limits on the share of the commodity market that can be held by financial investors. The limits would apply on a commodity-by-commodity basis. Specifically, the limits would cap the combined net long position, as a percentage of open interest on the futures markets, which may be held by all persons not engaged in bona fide hedging activities. The proposal directs the Commission to set the aggregate limits at a level that ensures sufficient market liquidity for bona fide hedging activities.