

# Commodity Funds: Impact on Price Discovery A CFTC Perspective

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# Role of the CFTC in Regulating Futures and Option Trading

- Section 3 (b) PURPOSE.—to deter and prevent price manipulation...insure financial integrity...protect all market participants from fraudulent or other abusive sales practices...
- Section 4a(a) EXCESSIVE SPECULATION—LIMITS ON TRADING... the Commission shall from time to time...fix limits on the amount of trading which may be done or positions held by any person that the Commission finds are necessary to diminish excessive speculation.

# Manipulation Not Typically an Issue

- Buy and hold strategy
- Transparent strategy
- Lack of market power
- Lack of intent

# Excessive Speculation Issues

- What is “excessive speculation”?
  - Too many speculators?
  - Too large of a speculative position?
  - Too active in the marketplace?
  - Too many speculators with homogeneous market views?

# Speculation by Index Traders

- Diverse investor group
  - Too many?
- Common investment interest
  - Homogeneous view?
- Contract rolls
  - Too large/active position?
- Influence on the overall forward curve
  - Too large of a position?

# Regulatory Approaches to Limiting Excessive Speculation

- Position limits
  - Effective for large traders
  - Not as effective for limiting an aggregation of smaller traders
- Trading limits
  - Potential to spread out rolls
  - Effective limits may vary depending on liquidity
- Margin
  - Funds often fully margined already

# Potential Downside to Limiting Index Trading

- Elimination of a potentially valuable investment strategy
- Reduced liquidity
- Substitution of regulatory control of market composition for marketplace control
- Unintended effect on other traders
- Less visible trading

# Other Measures to Deal With Large Index Fund Positions

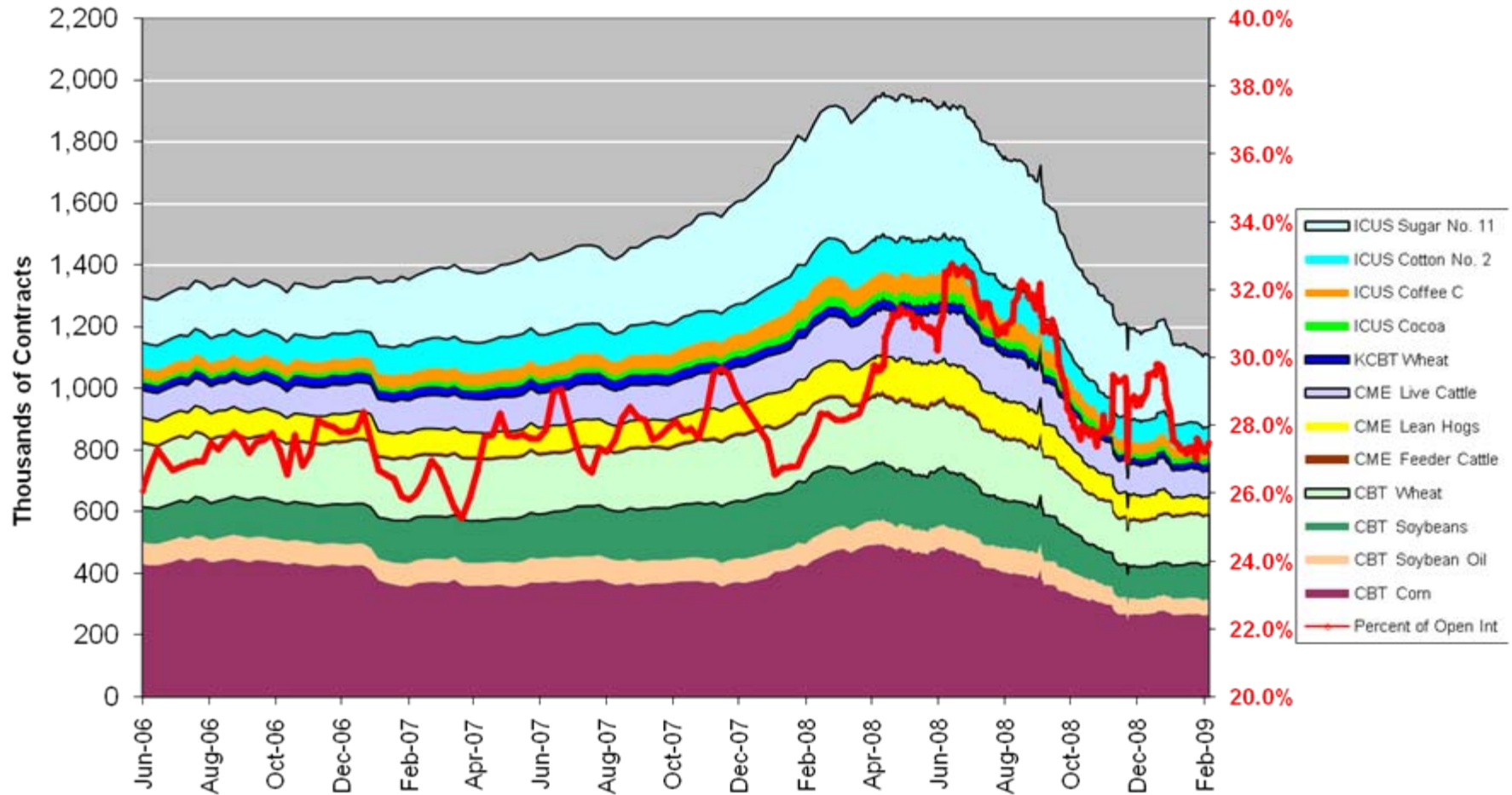
- The market mechanism
  - Too little, too late?
- Block Trading Facilities
- OTC Trading
- Transparency



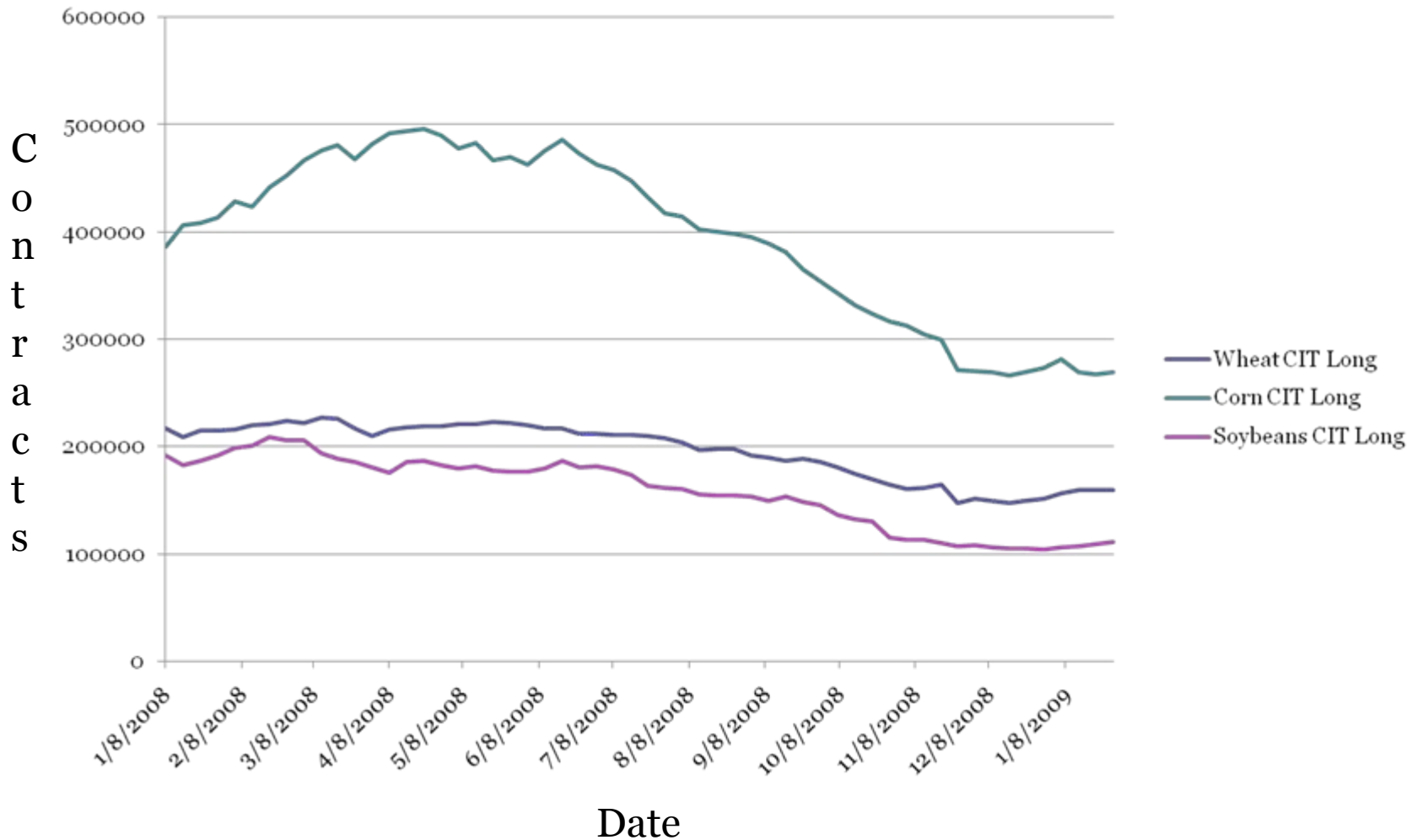
# CFTC Efforts to Enhance Market Transparency

- Supplemental COT Report
  - Launched Dec. 5, 2007
  - Index Trader Category for 12 selected ag products
  - Two-year pilot program
  - Disaggregation issues
- Staff Report on Commodity Swap Dealers & Index Traders
  - Released Sep 2008
  - Better describe the activity of swaps dealers and index traders

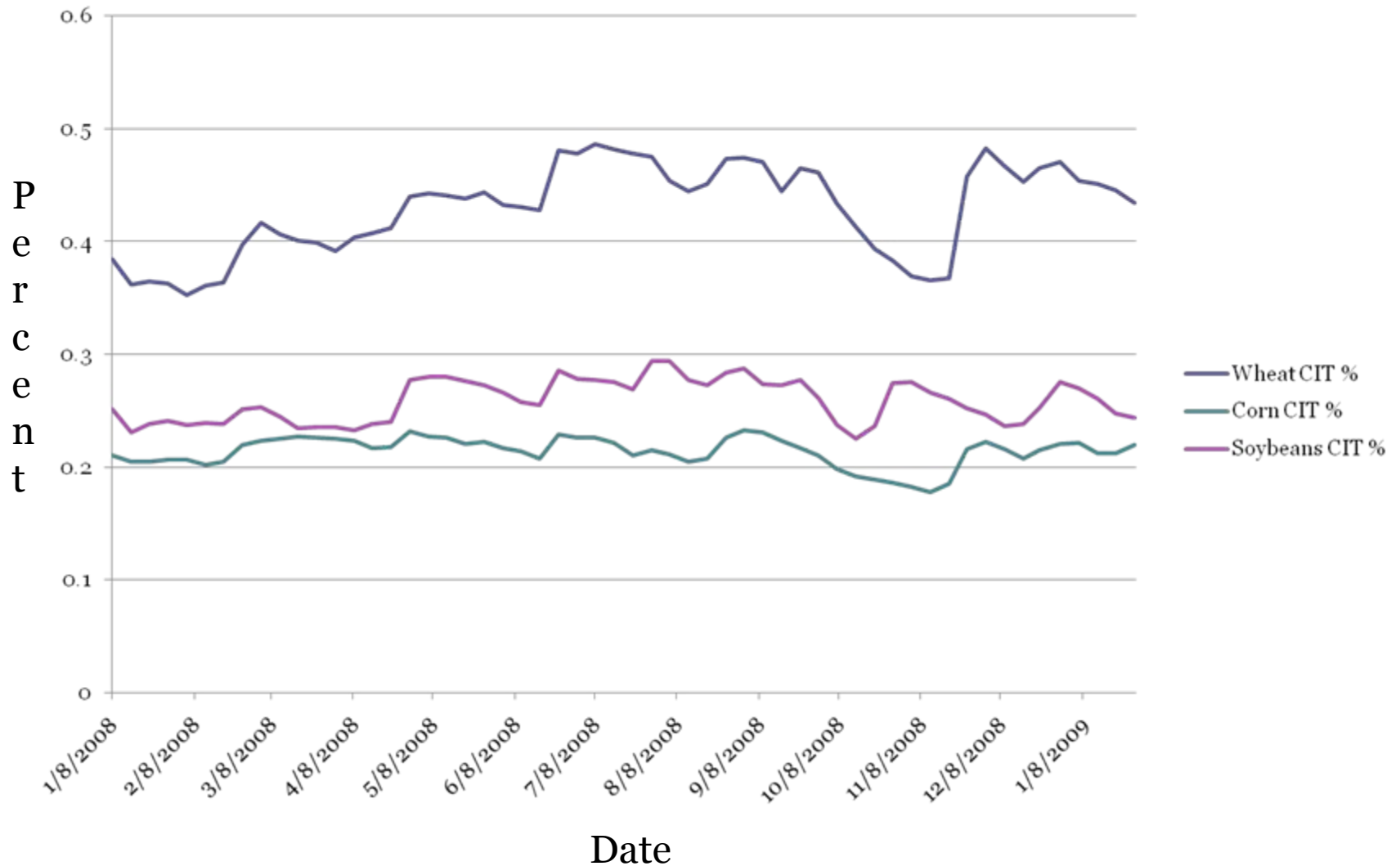
# Recent Activity by Index Traders



# Long Open Interest Held by Commodity Index Traders in CBOT Corn, Wheat and Soybeans



# Percentage of Open Interest Held by Commodity Index Traders in CBOT Corn, Wheat and Soybeans



# Staff Report on Commodity Swap Dealers & Index Traders as of June 30, 2008

- \$200 billion in commodity index trading
- Crude oil activity declined between Dec. 31, 2007 and Jun. 30, 2008
  - 408K futures equivalents to 363K equivalents
- Types of Index Traders
  - 24% Index Funds
  - 42% Institutional Investors
  - 9% Sovereign Wealth Funds
  - 25% Others

# Quarterly Report of Commodity Index Investments

End of Quarter Commodity Index Investment in Billions of Dollars

<b>Dec 2007</b>	<b>Mar 2008</b>	<b>Jun 2008</b>	<b>Sep 2008</b>	<b>Dec 2008</b>
\$146.0	\$167.6	\$199.9	\$128.3	\$77.0

# Changes in Commodity Index Trader Activity as of December 31, 2008

- \$77 billion in commodity index trading
- Index Investment in Selected Commodities

<b>Commodity</b>	<b>Jun 2008 (billions)</b>	<b>Dec 2008 (billions)</b>
Corn	\$13.1	\$4.9
Soybeans	\$10.9	\$4.7
Wheat (CBOT)	\$8.7	\$4.1
Live Cattle	\$6.5	\$3.4
Sugar	\$4.9	\$2.9
Lean Hogs	\$3.2	\$1.7
Coffee	\$3.1	\$1.5
Cotton	\$2.9	\$1.2

# Links to CFTC Reports at www.cftc.gov

- COT and COT Supplemental Reports
  - <http://www.cftc.gov/marketreports/index.htm>
- Staff Report on Swap Dealers
  - <http://www.cftc.gov/newsroom/generalpressreleases/2008/pr5542-08.html>