

# PUBLICATION

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## "London Loophole" for Oil Trading Narrowed by CFTC No-Action Letter

June 24, 2008

On June 12, 2008 Senator Carl Levin (D - Michigan) introduced the Close the London Loophole Act (CTLLA) as a proposed amendment to Section 4 of the Commodities Exchange Act (CEA) in reaction to recent observations that speculators have driven up the price of futures contracts on U.S. oil products. One week later, on June 17, 2008 the Commodities Futures Trading Commission (CFTC) amended the no-action letter under which U.S. customers are permitted access to ICE Futures Europe, a primary exchange which permits the trading of contracts in oil and oil-related products.

The amended no-action letter from the CFTC:

- imposes comparable NYMEX position limits and hedge exemption requirements on ICE Futures Europe;
- requires ICE Futures Europe to inform the CFTC of requests for hedge exemptions and whether disciplinary action was taken against those traders who exceed position limits; and
- requires ICE Futures Europe to provide daily "large trader" reports to the CFTC.

The CTLLA takes the no-action letter several steps further, namely giving the CFTC "direct authority" to order a trader in the U.S. to reduce positions on overseas exchanges in consultation with local exchange regulators. CTLLA, however, would not apply to those traders on overseas exchanges who are based outside of the U.S.

The ICE Futures Europe - West Texas Intermediate Crude Oil (WTI) Contract is cash-settled against the New York Mercantile Exchange (NYMEX) WTI Crude Oil contract. Other contracts on ICE Futures Europe for U.S. unleaded gasoline and U.S. heating oil are similarly settled against contracts on the NYMEX. As position limits on contracts on U.S. exchanges do not generally apply on exchanges outside of the U.S.; traders in these contracts may seek to assume larger positions by using an exchange that is not located in the U.S.

Investment managers who utilize funds that trade contracts on ICE Futures Europe should speak with fund managers to ascertain what systems and procedures will be implemented to comply with the recent guidance from the CFTC and what assistance they will receive from the brokerage firms through which they purchase and sell contracts. Regulatory authorities in the United Kingdom, noting what they called "regulatory imperialism," expressed reluctance to honor the CFTC's directives. Those who are clearly subject to the CFTC's jurisdiction should weigh the regulatory risks of dealing with firms that choose to follow the pronouncement of the United Kingdom regulators. The CFTC's recent guidance doesn't make clear whether a U.S. fund-of-funds manager who hires a non-U.S. trader will ultimately trigger regulatory scrutiny, but these types of managers can reasonably expect the imposition of U.S. exchange position limits in the near future.