Statement of
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Before the
United States Senate
Subcommittee on Financial Services and General Government
Of The
Committee on Appropriations
In Joint Session With The
Committee on Agriculture, Nutrition, and Forestry
June 17, 2008

I am Terrence Duffy, Executive Chairman of Chicago Mercantile Exchange Group Inc. ("CME Group" or "CME") Thank you Chairmen Durbin and Harkin and Ranking Members Brownback and Chambliss for this opportunity to present our views.

CME Group was formed by the 2007 merger of Chicago Mercantile Exchange Holdings Inc. and CBOT Holdings Inc. CME Group is the parent of CME Inc. and The Board of Trade of the City of Chicago Inc. (the "CME Group Exchanges"). CME Group also owns Swapstream Operating Services Limited, an OTC trading facility, and owns an interest in FXMarketspace Limited, an FX trading platform that is authorized and regulated by the Financial Services Authority. The CME Group Exchanges are neutral market places. They serve the global risk management needs of our customers and producers and processors who rely on price discovery provided by our competitive markets to make important economic decisions. We do not profit from higher food or energy prices. Our Congressionally mandated role is to operate fair markets that foster price discovery and the hedging of economic risks in a transparent, self-regulated environment, overseen by the CFTC.

The CME Group Exchanges offer a comprehensive selection of benchmark products across all major asset classes, including futures and options based on interest rates, equity indexes, foreign exchange, agricultural commodities, energy, and alternative investment products such as weather and real estate. We also offer order routing, execution and clearing services to other exchanges.

We unequivocally support your efforts to materially improve the enforcement capabilities and machinery of the CFTC and to do so in a manner that does not increase the costs of trading on fully regulated U.S. contract markets. We also are enthusiastic supporters of broadly expanding the mandatory reporting of energy trading and position information to the Commission. We share the view of regulators and legislators most famously expressed by Justice Louis Brandeis:

> "Publicity is justly commended as a remedy for social and industrial diseases. Sunlight is said to be the best of disinfectants; electric light the most efficient policeman."
> --Justice Louis Brandeis, Other People's Money, and How the Bankers Use It, 1933

We believe that disclosure of trading and position information to a regulator with sufficient resources to analyze and act on unusual or suspicious activities will deter most potential manipulators and assure punishment of those foolish enough to attempt a manipulation when all of their actions are visible to the regulator. This is the philosophy upon which our internal market regulation has been based and why it has been so successful.

We also clearly understand that the recent surge in the prices of many commodities, particularly energy, has inspired Congress to look for assurance that the only price drivers are legitimate supply and demand factors. Some who claim expertise or special knowledge have asserted that the entire price inflation can be laid at the door of speculators and/or passive index funds that have invested billions in commodity contracts. The more cautious critics have suggested that there may be a froth of inflation caused by speculation. Our careful, up-to-date evaluation of market participants and trading patterns in the commodities traded at CME and CBOT are to the contrary as I will explain below. We will be placing relevant information on our website, which will permit others to review our findings to date respecting the impact of speculation on our markets.

Our economists make convincing arguments that neither speculators nor index funds are distorting commodity prices. Previous studies have concluded that speculation has not been responsible for any significant, persistent volatility in futures markets. Nonetheless, we are strong proponents of securing all of the relevant information from all sources and fairly testing the hypothesis and reconfirming previous academic studies. While we expect that the evidence respecting the impact of speculation and index trading in energy markets will parallel the results we have found in our own markets, we agree that there is no reason to rely entirely on economic theory when the data is or can be made available. We support the CFTC's and Congress's efforts to secure this data and to assure that a thorough analysis informs any subsequent legislative or administrative efforts to deal with uneconomic price inflation.

1. Speculation is essential to efficient, liquid markets.

Current fuel and food prices are shocking and painful to consumers and the economy. Unfortunately, the pressure to reverse rising prices has led some to look for a simple, causal agent that can be neutralized with the stroke of a pen. The favored culprit is the traditional villain--speculators. But speculators sell when they think prices are too high and buy when they think prices are too low. They are not a unified voting block and are on both sides of every market. Speculative selling and buying send signals to producers and processors that help keep our economy on an even keel. High futures prices for corn induced farmers to bring new acreage to market. High forward energy prices encourage exploration and new technology to exploit existing untapped reserves and conservation and other behavioral changes to adjust demand.

Futures markets perform two essential functions—they create a venue for price discovery and they permit low cost hedging of risk. Futures markets depend on short and long term speculators to make markets and provide liquidity for hedgers. Futures markets could not operate effectively without speculators and speculators will not use futures markets if artificial barriers or tolls impede their access. Blaming speculators for high prices diverts attention from the real causes of rising prices and does not contribute to a solution.

The weight of the evidence and informed opinion confirms that the high prices are a consequence of normal supply and demand factors. The Wall Street Journal surveyed a significant cross section of economists who agreed that: "The global surge in food and energy prices is being driven primarily by fundamental market conditions, rather than an investment bubble . . . ."[1]

The traditional production/consumption cycle that has governed prices in commodity markets is stressed by the confluence of a number of factors. David Hightower, author of the Hightower report summed up the supply/demand situation in corn last year as follows: " We have experienced three consecutive years of record corn production… and three consecutive years of declining ending reserves. Supply has put its best team on the field and demand keeps winning."

We have identified six significant factors that are influencing the supply and demand for grains and oilseeds; each is important.

1. Weather/Disease/Pestilence;

2. Increasing per capita consumption in the emerging markets;

3. The dramatic impact of the demand for grain and oil seeds as feed stock for biofuel;

4. Reactionary governmental trade policies; and

5. Financial Market turmoil, including a weakened dollar;

These factors combine to create volatile markets and increased prices.

1. Weather/Disease/Pestilence: This is of course a traditional factor in the grain markets. Wheat recently attained all-time record prices, coincident with 60 year lows in world stockpiles. In the past two years there have been production shortfalls in Australia, Argentina, Europe, North America, and

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[1] **Bubble Isn't Big Factor in Inflation, By Phil Izzo (May 9, 2008; Page A2**

the Ukraine due to a combination of drought in some places, untimely rains in others, and even infestation by the Eurygaster beetle.

2. Per Capita Consumption in Emerging Markets: While some projections imply a slowing population growth in this century, global population is still growing and from an ever increasing base. In the short-run, GNP and personal income levels in the large emerging market countries such as India, China, Russia and Brazil are creating unprecedented per capita demand growth for animal protein. As is common in human history, as a society grows richer, its diet expands to include additional animal protein in the form of meat and dairy. According to a report on Bloomberg.com, worldwide meat consumption is forecast to increase by more than half by 2020; most of the new demand will come from China. The implications for grain demand will be staggering. Already in just the past 12 years, China has gone from a net exporter of soybeans to the world's largest importer of soybeans with soybean imports projected to easily exceed 30 million tons in 2007. Never before in history have we witnessed the impact of 2 billion people asking for a higher standard of living at the same time.

3. Growth in Biofuels: The mandate to produce biofuels created additional market stress. The expectation is for continued growth in biofuel use/demand; politics rather than logic is at work - resulting in continued demand growth for feed grains and vegetable oils. To illustrate this point; The 2005 energy bill in the U.S. spurred the rush to plant approximately 93 million acres of corn in 2007, the highest level since World War II. The USDA recently reported that corn based ethanol production will continue to rise placing additional demands on the crop: "driven by continued expansion in ethanol production capacity, corn use for ethanol is projected at 4.1 billion bushels 2008-9, up 28% from the current year projection. Ethanol corn will now account for 31% of total corn use, up from a projected 25% for 2007-8." The amount of corn used in ethanol production just 5 years ago was approximately 10%. In addition to the US initiative, the EU enacted legislation that will require significantly increased use of biofuel fuel by 2010. The problem is that there simply is not enough land to set aside in all of the EU to meet these ambitious requirements; they will need to import

significantly higher levels of either finished product or higher levels of oilseeds in order to produce the needed biofuel.

4. Reactionary Government Trade Policies: During the last 3 months, there has been an ever expanding pattern of increasing export tariffs and decreasing import tariffs on grains and oilseeds by foreign governments. Russia extended a grain export tariff from April 30 to July 1. In addition, they have placed an export ban upon their grain to the four CIS (Commonwealth of Independent States) members designed to prevent re-export of Russian grain to third countries. Argentina extended their wheat export closure to April 8, and announced a new, higher soy export tax that will rise by 7-9 percentage points based upon current prices. India increased its grain export tariffs while lowering import tariffs on edible oils. China has announced a further increase in edible oil imports in 2007-8 with projections currently up an additional 14%. South Korea announced the emergency lifting of import tariffs on 70 price sensitive products, including wheat and corn in an effort to confront rising inflation. The pattern we are witnessing is one of keeping domestic production off the global market while lowering barriers for the acquisition of grains and oils from the global market resulting in increased demand for U.S. grain and Oil Seed products.

5. Financial Market Turmoil: The events that began in the sub-prime sector of the financial markets are now spreading out with very serious and negative consequences throughout the nation's banking sector. Restrictive lending policies are having deleterious effects within our market place. High volatility leads to higher margins, large directional price moves require significant continuing variation deposits and all of this comes at a time when money is difficult to obtain.

In addition to concerns expressed about speculators in general, there have been more specific suggestions that money managers and hedge funds that operate under defined strategies may have impaired the price discovery process. The CFTC's staff responded to question implying that managed money traders, particularly hedge funds, "may exert undue collective influence on markets and thus move prices in ways that hinder the market's price discovery role, reduce the effectiveness of hedges constructed with

contracts from those markets and raise trading costs." CFTC's professional staff conducted an analysis in 2005 which came to the following conclusions[2]:

> "Using a unique set of data from the Commodity Futures Trading Commission (CFTC), the staff studied the relationship between futures prices and the positions of managed money traders (MMTs), commonly known as hedge funds, for the natural gas and crude oil futures markets. The staff also examined the relationship between the positions of MMTs and positions of other categories of traders (e.g., floor traders, merchants, manufacturers, commercial banks, dealers) for the same markets.
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> The results suggest that on average, MMT participants do not change their positions as frequently as other participants, primarily those who are hedgers. The staff found that there is a significant correlation (negative) between MMT positions and other participant's positions (including the largest hedgers), and results suggest that it is the MMT traders who are providing liquidity to the large hedgers and not the other way around.
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> The staff also found that most of the MMT position changes in the very short run are triggered by hedging participants changing their positions. That is, the price changes that prompt large hedgers to alter their positions in the very short run eventually ripple through to MMT participants who will change their positions in response. The staff also found no evidence of a link between price changes and MMT positions (conditional on other participants trading) in the natural gas market, and find a significantly negative relationship between MMT position changes and price changes (conditional on other participants trading) in the crude oil market."

In recent congressional testimony the CFTC has reaffirmed the validity of this 2005 analysis.[3] It is instructive that CFTC's analysis parallels

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[2] **http://www.cftc.gov/opa/press05/opa5074-05.htm**

the conclusions of many other economists who have also studied the issue of causation in the context of speculators and commodity futures prices.[4]

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[3] During his appearance before the Senate Appropriations Committee on May 7, 2008, CFTC's Acting Chairman Walt Lukken stated that the CFTC's recent revisitation of the 2005 study using more current data for energy market trading affirmed the conclusions reached in the 2005 study. This conclusion mirrors the views of the majority of 53 economists surveyed by the Wall Street Journal in May 2008 which indicated that the global surge in food and energy prices is being driven primarily by fundamental market conditions, rather than an investment bubble. Wall Street Journal, May 9, 2008, page A-2. Similarly, the US Department of Energy's Energy Information Agency's most recent "Short Term Energy Outlook" published in May 6, 2008 evidenced the tightness in world oil markets, with growth in world oil consumption outstripping growth in production in non-OPEC nations by over 1 million bbls/day, and dramatically increased demand coming from China, India and other parts of the developing world.

[4] See, for example, Antoshin and Samiei's analysis of the IMF research on the direction of the "causal arrow" between speculation and commodity prices in "Has Speculation Contributed to Higher Commodity Prices?" in World Economic Outlook (September 2006):

"On the other hand, the simultaneous increase in prices and in investor interest, especially by speculators and index traders, in commodity futures markets in recent years can potentially magnify the impact of supply-demand imbalances on prices. Some have argued that high investor activity has increased price volatility and pushed prices above levels justified by fundamentals, thus increasing the potential for instability in the commodity and energy markets.

What does the empirical evidence suggest? A formal assessment is hampered by data and methodological problems, including the difficulty of identifying speculative and hedging-related trades. Despite such problems, however, a number of recent studies seem to suggest that speculation has not systematically contributed to higher commodity prices or increased price volatility. For example, recent IMF staff analysis (September 2006 World Economic Outlook, Box 5.1) shows that speculative activity tends to respond to price movements (rather than the other way around), suggesting that the causality runs from prices to changes in speculative positions. In addition, the Commodity Futures trading Commission has argued that speculation may have reduced price volatility by increasing market liquidity, which allowed market participants to adjust their portfolios, thereby encouraging entry by new participants."

Similarly, James Burkhard, managing director of Cambrindge Energy Research Associates testified to the Senate Energy Committee on April 3, 2008 that: "In a sufficiently liquid market, the number and value of trades is too large for speculators to unilaterally create and sustain a price trend, either up or down. The growing role of non-commercial investors can accentuate a given price trend, but the primary reasons for rising oil prices in recent years are rooted in the fundamentals of demand and supply, geopolitical risks, and rising industry costs. The decline in the value of the dollar has also played a role, particularly since the credit crisis first erupted last summer, when energy and other commodities became caught up in the upheaval in the global economy. To be sure, the balance between oil demand and supply is integral to oil price formation and will remain so. But 'new fundamentals'—new cost structures and global financial dynamics—are behind the momentum that pushed oil prices to record highs around $110 a barrel, ahead of the previous inflation-adjusted high of $103.59 set in April 1980."

2. Raising Margin Above Prudential Levels is Counterproductive

Neither the CFTC's study nor careful marshalling of the supply/demand factors driving the market has calmed the critics who demand an easy solution to high prices, which they claim can be mandated without cost or consequence. This vocal group insists that driving speculators from the markets will bring prices back to the correct level. Worse still, they argue for driving speculators from the market by government mandated increases in margins.

Legislation has been proposed to mandate increases in margin, by which is meant the performance bond required of futures traders to guarantee performance of their contractual obligations to the clearing house. The theory behind the legislation is that speculators who have long positions and whose participation in the futures markets is assumed to have caused price escalation, will be driven from the market and prices will retrench to a more comfortable level. This idea is flawed.

First, it assumes that speculators are all on the long side of the market and that this herd approach to trading has driven prices above their legitimate equilibrium level. All of our internal studies and all of the academic work supports the opposite view, namely that speculators are about equally divided on both sides of the market.

Second, increasing margin to artificially high levels is most likely to cause a price spike rather than to systematically lessen commodity prices. We strongly believe that efforts to mandate price by direct price control or by indirect actions distort future production and cause costly misallocation of resources of production.

Performance bond is generally set at a level to cover, with a high degree of confidence, any change in the underlying value of a futures contract during a single day of trading. It has nothing to do with the notional or face amount of the contract. For example, performance bond on a $36,700 CBOT corn contract is currently set at $2,025 while performance bond on a $100,000 thirty year bond contract is set at $3,510. In each case, the holder of the contract must make good on his losses and conversely gets

credit for his gains on a daily basis. Our clearing system continuously holds 100% collateral for a near worst case loss scenario. The cost of depositing collateral or cash with the clearing house is considered a cost of trading.

The imposition of artificially high performance bonds is a tax on trading as it raises a trader's cost. It has been repeatedly demonstrated, and ever more so as markets have become electronic and available from anywhere on the globe, that excess performance bond levels will drive users away from transparent, regulated U.S. futures markets and into opaque, unregulated OTC markets with less liquidity, less price transparency and no public accounting for traders' positions. This is a net loss to the Congressionally defined purpose of creating fair, efficient and well-functioning energy and commodity markets.

Our extensive market regulation experience and our experience with previous efforts to control commodity prices by means of adjusting the level of performance bond has established that artificially increasing margins is not effective. Raising margins to drive speculators on the long side of the market out of the market in a time of upward trending prices does not work. The speculators who have been long have been collecting the profits on their positions and are in an especially strong position to meet any additional margin call. Moreover, they are well aware that the short side of the market has been losing money and probably has been forced to borrow to support their short hedges.

A North Dakota farmer who sold corn futures at a new high of $5 a bushel and locked in a $2 per bushel profit needs to be able to carry his hedge until his crop is harvested. A single contract is 5,000 bushels and margin is now set at $1,000 per contract. Assume the farmer had sold 100 contracts. Corn was $7 this morning and the farmer has been forced to go to his bank to borrow $2*5,000*100=$1,000,000 to continue to carry the position. What should the long speculator expect when margins are raised and the farmer is forced to borrow $3 million or more to continue to hold his position? The cost to hedgers can be expected to be even more severe when the country is in the midst of a severe credit crunch.

Moreover, there is no evidence that artificially increasing performance bonds will drive well-capitalized index funds or other passive long-only investors to sell or that the impact of any such selling would be beneficial or positive for hedgers and commercial users of futures markets. Generally, these investors are not leveraged and are in the best position to margin up to 100%. Long index traders will not be driven from the market because they already have a fully collateralized account that is held on behalf of their clients. By increasing the amount of those funds that are required to be posted for margin, the index trader just transfers treasury bills from one account to an account accessible to the clearing house. There is no cost to this class of trader.

Performance bonds are designed to ensure that contractual obligations are met and that clearing houses can fulfill their responsibilities; they are not intended to create incentives or disincentives for trading decisions. Based on our strong track record of zero credit defaults in the 100-plus year history of CME Clearing, we believe our current system for calculating margin is the most prudent and sound approach to margining. Mandating arbitrary margin levels would not improve the functioning of energy and commodity futures markets and would interfere with the prudential risk management practices of central counterparty clearing houses.

Others have suggested excluding pension funds and index funds from participating in commodity futures markets. These funds are using commodity exposure to decrease volatility in their portfolios. Barring them from regulated U.S. futures markets will only push them offshore or into over-the-counter trading. These funds will continue to need commodities as an asset class and will need to find ways to invest on behalf of their clients. We believe it would be prudent to ensure this investment occurs on a regulated market instead of driving this capital into opaque markets.

CME Group has conducted a thorough review of the impact of index trading and speculative trading on its primary agricultural markets. We have found a negative correlation between price increases and index fund buying.

While we favor a broader study of the impact of index fund trading, we do not think it is appropriate to cast those funds as a villain in price inflation until the study is completed. Especially since in theory it is not likely that the index funds are having a detrimental impact. Index funds buy and hold. They may have some small impact on days when new money enters the market and they create additional net long positions, but those changes are transitory. The important statistic in this regard is new net positions not overall positions.

After the flow of new money into the market from the index funds, the price will, in the absence of other factors, revert to the equilibrium dictated by current supply and demand factors because the index traders simply sit and hold the positions until they roll to the next delivery month. Traders making informed trades should be expected to drive the market to equilibrium.

All price changes take place at the margin as those traders with information, meaning that they are hedging or expressing an opinion based on knowledge, buy and sell. Even if 30% of the open interest in a particular contract month of a commodity is held by index funds, buying and selling by a few traders based on need and knowledge drive the market to its fair equilibrium price. The open positions of the index traders have no impact on prices driven by informed trading activity.

Regulated futures markets and the CFTC have the means and the will to limit speculation that might distort prices or distort the movement of commodities in interstate commerce. Acting Chairman Lukken's recent testimony before the Subcommittee on Oversight and Investigations of the Committee on Energy and Commerce United States House of Representatives (December 12, 2007)[5] offers a clear description of these powers and how they are used.

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[5] **http://www.cftc.gov/stellent/groups/public/@newsroom/documents/speechandtestimony/opalukken-32.pdf**

CEA Section 5(d)(5) requires that an exchange, "[t]o reduce the potential threat of market manipulation or congestion, especially during trading in the delivery month . . . shall adopt position limitations or position accountability for speculators, where necessary and appropriate."

All agricultural and natural resource futures and options contracts are subject to either Commission or exchange spot month speculative position limits – and many financial futures and options are as well. With respect to such exchange spot month speculative position limits, the Commission's guidance specifies that DCMs should adopt a spot month limit of no more than one-fourth of the estimated spot month deliverable supply, calculated separately for each contract month. For cash settled contracts, the spot month limit should be no greater than necessary to minimize the potential for manipulation or distortion of the contract's or underlying commodity's price. For the primary agricultural contracts (corn, wheat, oats, soybeans, soybean meal, and soybean oil), speculative limits are established in the Commodity Exchange Act and changes must be approved via a petition and public rulemaking process.

With respect to trading outside the spot month, the Commission typically does not require speculative position limits. Under the Commission's guidance, an exchange may replace position limits with position accountability for contracts on financial instruments, intangible commodities, or certain tangible commodities. If a market has accountability rules, a trader – whether speculating or hedging – is not subject to a specific limit. Once a trader reaches a preset accountability level, however, the trader must provide information about his position upon request by the exchange. In addition, position accountability rules provide an exchange with authority to restrict a trader from increasing his or her position.

Finally, in order to achieve the purposes of the speculative position limits, the Commission and the DCMs treat multiple positions held on a DCM's market that are subject to common ownership or control as if they were held by a single trader. Accounts are considered to be under common ownership if there is a 10 percent or greater financial interest. The rules are applied in a manner calculated to aggregate related accounts.

Violations of exchange-set or Commission-set limits are subject to disciplinary action, and the Commission, or a DCM, may institute enforcement action against violations of exchange speculative limit rules that have been approved by the Commission. To this end, the Commission approves all position limit rules, including those for contracts that have been self-certified by a DCM.

It is clear that speculation is an important component of the futures markets, but there is a point when excessive speculation can be damaging to the markets. As a result, the CFTC closely monitors the markets and the large players in the markets, in addition to position and accountability limits, to detect potentially damaging excessive speculation and potential manipulative behavior.

3. The CFTC's exclusive jurisdiction over trading on CFTC regulated markets must be preserved.

CME Group plans to join with other leading participants in the financial services industry to respond to the FTC's request for comments respecting its proposed rule respecting false reporting and manipulative activities in the wholesale oil market. We are concerned that the FTC's jurisdictional reach could come into conflict with the CFTC's exclusive jurisdiction respecting futures trading. While the statute very clearly limits the FTC's jurisdiction to conduct in connection with "the purchase or sale of crude oil, gasoline or petroleum distillates **at wholesale**," FERC, which has similar authority, has read "in connection with" to give it authority over conduct that took place entirely on a futures exchange.

In 1974, Congress recognized the overriding importance of entrusting to the expertise of the CFTC the exclusive regulatory authority over the nation's futures markets. Congress preempted other federal and state rules that would either assert parallel jurisdiction over the futures markets or produce conflicts with the CFTC regulatory regime. This system has produced the best regulated, most innovative and efficient futures market in the world.

As markets evolve and become more interrelated such agency "boundary disputes" can be expected and for the most part the agencies usually take pains to accommodate one another to allow each to accomplish the mission Congress mandated for them. We are concerned by the Federal Energy Regulatory Commission's (FERC) claim of jurisdiction in the Amaranth case, where the only manipulative trading alleged took place on a futures exchange. FERC has refused to recognize and yield to the CFTC's exclusive jurisdiction. The result is that participants in the natural gas futures markets no longer have legal certainty as to the legal standard governing their transactions.

The recently enacted Farm Bill demonstrates the continued vitality of the CFTC's exclusive jurisdiction. Congress reauthorized the CFTC for

another five years and granted the CFTC new authority to regulate certain exempt commercial markets that are active enough to constitute price discovery markets.

4. Position Limits on Foreign Boards of Trade Listing Clones of U.S. DCM Listed Contracts

Position limits are a device to promote liquidation and orderly delivery in physical contracts. If two markets share the same physical delivery contract it is consistent to apply a single limit across both markets. However, we are not aware of a foreign board of trade that lists a physically deliverable futures contract that is a clone of a U.S. DCM's listed contract.

The ICE U.K. market lists a WTI crude oil contract that is traded and settled based on the settlement prices of the NYMEX WTI contract. The ordinary reasons for imposing position limits on futures markets do not apply in such a case. It is possible to imagine a trader who is long a limit position at NYMEX and double that position at ICE U.K. That trader might expect to profit, if not caught, by driving up the settlement price on the final day of trading on NYMEX by standing for delivery, even though he would be required to store and then sell the oil back at a loss, in the hope to profit from the settlement on ICE. Of course, such behavior will be obvious to the regulators and the markets and the manipulator would neither enjoy the profits nor much additional freedom. Moreover, the impact on the price of oil would be transitory.

Our theoretical understanding aside, we support a temporary imposition of position limits on the ICE Futures U.K. WTI contract until the CFTC is able to secure and analyze a more complete data set respecting the impact of speculation and/or indexed commodity trading on price inflation. We do not imagine that any harm will be done and this action will allay concerns.

5. The exemption for commercial markets in energy products, even as limited by the recent amendment of the CEA, is unnecessary and creates information gaps.

Section 5(b) of the Commodity Exchange Act charges the Commission with a duty to oversee "a system of effective self-regulation of trading facilities, clearing systems, market participants and market professionals" and to "to deter and prevent price manipulation or any other disruptions to market integrity; to ensure the financial integrity of all transactions subject to this chapter and the avoidance of systemic risk; to protect all market participants from fraudulent or other abusive sales practices."

These "purposes" and the statutory exemption for Commercial Markets found in Section 2(h)(3) are in conflict. The key purposes mandated by Congress in Section 5(b) are jeopardized if trading facilities for contracts in exempt commodities are permitted to coexist with regulated futures exchanges that list those same commodities. ECMs do not have any system of "effective self regulation" of their facilities or of their market participants. Their contracts are traded based on the prices of commodities that have limited supplies and that have often been the subject of manipulative activity and disruptive market behavior. There is no mechanism in place "to deter and prevent price manipulation or any other disruptions to market integrity." The Commission cannot track the build up of dominant positions. At best the Commission has power to punish such conduct after the fact. We find this to be a serious problem that is at odds with Congress's intent behind the CFMA, which, if left unaddressed, jeopardizes the public's confidence in the CFTC's ability to do its job.

The Section 2(h)(3) exemption for unregulated commercial markets should be eliminated. You can't fix the problem by merely changing reporting requirements. In order to secure accurate reports a market needs an effective surveillance and compliance system. This requires that an effective system of self regulation must be put in place. The logical conclusion is you must implement at least the core principles required of a DTEF to get a useful result.

In the aftermath of the Amaranth controversy, Congress provided CFTC new authorities in the Farm Bill to regulate "significant price discovery contracts" on platforms like ICE by requiring those platforms to

meet certain core principles drawn from the longer list applicable to fully regulated exchanges. What is clear is that when Congress wants to insure fair dealing and regulatory propriety it uses as its comparative yardstick the regulatory regime imposed on America's fully regulated exchanges.

Trading that is conducted on fully regulated exchanges is an open book to which you already have complete access and accountability. Indeed, CFTC monitors that exchange trading daily and has repeatedly opined that speculation on those fully regulated exchanges does not raise regulatory concerns. But that is not the case with the other forms of energy commodity trading, which lie outside the reach of CFTC regulation and are far larger in size in terms of trading volume.

Conclusion:

CFTC regulated futures markets have demonstrated their importance to the economy, the nation's competitive strength and America's international financial leadership. Imposing arbitrary increases in margins in these markets, as has been suggested as a way to control prices, will result in the exportation of these markets to overseas competitors and to unregulated and non-transparent over-the-counter markets. We have the means and the power to protect markets against speculative excesses on our markets and are committed to doing so.