

**Statement of
Terrence A. Duffy
Executive Chairman of CME Group Inc.
Before the
United States House of Representatives
Committee on Agriculture
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I am Terrence Duffy, Executive Chairman of Chicago Mercantile Exchange Group (“CME Group” or “CME”) Thank you, Chairman Peterson and Ranking Member Goodlatte, for this opportunity to present our views.

The CME Group exchanges are neutral market places. They serve the global risk management needs of our customers, 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.

My theme today is direct and indisputable. Even if every economist and every member of Congress had genuine evidence that excess speculation was distorting prices, it would be a monumental mistake to try to cure that problem by mandating an arbitrary increase in performance bond, commonly called margin, above prudent levels.

- First, the impact would be more likely to drive prices in favor of the speculators and counter to the desired outcome.
- Second, arbitrarily high performance bond is the equivalent of a toll or a tax on the use of regulated markets. Its effect would be to drive trading off-shore or into unregulated venues in clear contravention of the purposes of having well regulated markets in this country.

For the record, it is essential to report that we see no evidence whatsoever that excessive speculation in futures markets is distorting prices. We renewed our research on this topic earlier this year when we were inundated with unverified claims that driving speculators from futures markets will bring commodity prices, in particular oil, back to some “correct” lower level.

Fortunately, in addition to our own research findings, enough time has passed to permit a strong counter-current from economists and editorial writers debunking those false claims.

Nonetheless, legislation has been proposed to mandate margin increases, which would require hedgers and speculators to increase the level of performance bond required to guarantee performance of their contractual obligations to the clearing house. One bill attempts to limit the increase to speculators who are not the counterparties to hedgers.

The questionable theory behind this legislation is that increased costs will drive speculators out of the futures markets and prices will retrench to more comfortable levels because speculators with long positions are assumed to have caused price escalation in the first place.

This idea is seriously flawed and reflects a lack of understanding of the role of margin in futures markets.

Given the critical juncture of policy deliberations, it is imperative that Congress recognize the fallacies behind the demands to use margin increases to control commodity prices.

- First, advocates of arbitrarily raising margin assume 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 the leading academic work in the field, as well as our extensive studies, support the opposite view – namely, that speculators are about equally divided on both sides of the market.

- Second, increasing margin to artificially high levels will most likely cause a price spike rather than systematically lessen commodity prices.
- Moreover, mandated price by direct price control, or by indirect actions, distort future production and cause costly misallocation of resources of production.
- Third, the imposition of artificially high performance bond is a tax on trading as it raises a trader's cost. This has been repeatedly demonstrated, and ever more so as markets have become electronic and available from anywhere around the globe. Indeed, excessive performance bond levels drive users away from transparent, regulated U.S. futures markets and into opaque, unregulated over-the-counter markets.

And remember, the OTC markets have 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.

Raising margin 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. They are in an especially strong position to meet any additional margin calls.

Moreover, they are well aware that commercial hedgers on the short side of the market have been losing money and probably have been forced to borrow to support their short hedges. Therefore, they will be pressed to meet increased margin calls and forced out of the markets.

Furthermore, there is no evidence that artificially increasing performance bond will drive well-capitalized index funds or other passive long-only investors to sell. Nor is there evidence that the impact of any such selling would be beneficial or positive for hedgers and commercial users of futures markets.

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.

One of the pending bills attempts to deal with the adverse impact on hedgers by giving relief to the speculator on the opposite side of the hedger. There is no such person. Every hedge transaction invites a chain of speculators as counterparties over its lifetime.

In fact, the counterparty to every futures contract is the clearing house, not any identifiable speculator. Therefore this approach will not work.

While the suggestion that margin increases can cure inflation and reduce the cost of oil by 30 to 40 percent is understandably seductive on a political level, Congress can ill afford to make a misstep in this regard. The downside risk of arbitrarily mandating increased margin for futures is enormous.

Congress's credibility is at risk in adopting simplistic, ill-conceived responses that are destructive to U.S. futures markets and those who legitimately rely on those markets.