

COMMODITY FUTURES MARKET REFORM

The Commodity Futures Trading Commission (CFTC) is the federal government regulator of commodity futures and futures options markets in the U.S. These energy commodity contracts fall under CFTC jurisdiction; crude oil, gasoline, diesel fuel, heating oil, propane, electricity and natural gas. Trading on these contracts takes place predominately on the New York Mercantile Exchange (NYMEX) with over \$1.5 trillion traded daily. However, a growing number of trades (over one million daily) are being made on “over the counter (OTC)” or electronic exchanges such as the Intercontinental Exchange (ICE). The Government Accountability Office (GAO) estimates that trading volume in some unregulated markets rose more than 400 percent in 2006 alone. This is a serious problem that needs an aggressive legislative response, especially in light of the 2008 unprecedented run-up in energy prices.

Independent gasoline marketers and heating oil dealers have lost faith in the ability to use futures markets to determine a fair price for energy based on real-world supply and demand fundamentals. Countless Congressional hearings have revealed that there is inadequate transparency and that aggregate position limits are needed in the oil trading markets. Public and private pension funds, hedge funds, sovereign wealth funds and other institutional investors are heavily investing in futures contracts for crude oil and refined petroleum products, and enjoy little or no anti-manipulation controls, such as tough limits on speculative positions. Without sufficient oversight and aggregate position limits, market activity can distort the price of oil and other energy commodities.

Commodity futures markets were established as a tool for true physical hedgers to manage risk. Today, they have been highjacked as an investment tool by speculators looking to turn a profit. Pension funds, hedge funds, sovereign wealth funds and other institutional investments in commodities have exploded from \$13 billion in 2003 to \$317 billion in July 2008. Investment-only speculators that engage in a “buy and hold strategy” serve no purpose in the commodity markets, other than to diminish its role as a tool for managing risk and discovering a fair market price for physical hedgers such as petroleum marketers, airlines and farmers.

Most economists now agree that the U.S. economy entered a recession in December 2007 with the supply of crude oil increasing and the demand for crude oil decreasing during the first half of 2008, though oil prices continued to skyrocket. When crude oil reached \$150 a barrel for December delivery in July of 2008 and then fell to \$33 in December, it was not completely a result of supply and demand fundamentals – it was influenced by excessively-leveraged speculators, index investors and hedge funds.

During the first six months of 2008, index speculators and hedge funds poured \$55 billion into commodity indices which resulted in the buying of 145 million barrels of crude oil in the futures market. By late July and early August 2008, index speculators began to pull \$70 billion out of commodity indices which resulted in the selling of 230 million barrels of crude oil.

CONGRESSIONAL ACTION NEEDED

Earlier this year, the House Agriculture Committee passed the “Derivatives Markets Transparency and Accountability Act of 2009,” (H.R. 977). The legislation accomplishes many PMAA objectives. It requires foreign boards of trade that provide services to U.S. participants to adopt, for each of its contracts, position limits or position accountability standards for speculators, requires large trader reporting, requires the CFTC to classify index traders and swap dealers that would bring transparency to commodity markets, requires most over-the-counter (OTC) transactions to strict reporting requirements, increases staff at the CFTC, and finally, the legislation requires that most OTC transactions be settled and cleared through a CFTC regulated derivatives clearing organization (DCO).

PMAA applauds House Agriculture Chairman Collin Peterson (D-MN) for approving H.R. 977 out of the committee. PMAA urges Members of Congress to cosponsor H.R. 977 right away. To cosponsor, Members should contact: Jeremy Bratt, House Committee on Agriculture, P: 202-225-2171 jeremy.bratt@mail.house.gov.

We urge members of Congress to further strengthen the legislation by including aggregate position limits and an energy position limit advisory group consisting mostly of commercial interests.

Ultimately, final legislation must include the following elements:

- **Aggregate position limits (set by the control entity) on non-commercial traders on all commodity exchanges including the over-the-counter markets** that don't have any physical connection to the underlying commodity. This will return the market to those who really need the product in order to offer the lowest price possible to their consumer. Aggregate position limits will also prevent one trader from going into one commodity exchange and trading the maximum amount of crude oil allowed and then going into another exchange to trade another large amount of futures positions.
- **Distinguish between legitimate hedgers and those who are in the market for purely speculative purposes**, ensuring that traders who have no relationship to the physical product (such as investment banks and pension plans) are unable to trade as legitimate purchases.
- **Close the “London Loophole”** by requiring foreign exchanges with energy contracts for delivery in the U.S. and/or that allow U.S. access to their platforms to be subject to comparable rules and regulations that American exchanges must comply.
- **Close the “Swaps Loophole”** which allows so-called “index speculators” (that now amount to one-third of the market) an exemption on position limits which enable them to control unlimited amounts of energy commodities.
- **Increased staff** -- Provide CFTC additional employees and other resources.

PMAA STAFF CONTACT: Sherri Cabrera, scabrera@pmaa.org
Rob Underwood, runderwood@pmaa.org