

OPENING STATEMENT
SENATOR NORM COLEMAN
RANKING MINORITY MEMBER
SENATE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
JULY 9, 2007

Today's hearing is the culmination of an extensive Subcommittee investigation into the impact of excessive speculation on the natural gas market. Our inquiry builds on the Subcommittee's June 25, 2007, hearing as well as on the Subcommittee's February 2006 field hearing—held in my home state of Minnesota—and the Subcommittee's June 2006 staff report. These efforts, including today's hearing, have been bipartisan from their inception, and I would like to thank Chairman Levin and his staff for their hard work on these important issues.

As Senator Levin noted in his opening statement, the evidence reviewed by the Subcommittee reveals fundamental flaws in our current regulatory structure. Section 2(h)(3) of the Commodity Exchange Act exempts from CFTC oversight and regulation a massive, and growing, volume of energy transactions that occurs on electronic, over-the-counter (OTC) exchanges. In stark contrast to regulated exchanges, exempt exchanges have no responsibility to monitor trading, no responsibility to prevent excessive speculation or price manipulation, and no responsibility to ensure that trading is fair and orderly. The end result is a bifurcated regulatory regime. Futures exchanges like the New York Mercantile Exchange (NYMEX)—are both self-regulated and regulated by the CFTC. Whereas, other, increasingly significant, segments of our energy markets—namely, electronic, OTC exchanges like the Intercontinental Exchange (ICE)—are neither self-regulated nor regulated by the CFTC.

The Amaranth case history illuminates the inadequacy of this bifurcated regulatory structure and underscores the need for greater transparency and regulation on electronic, OTC energy exchanges.

From early 2006 until its September collapse, Amaranth traded heavily on both NYMEX, a regulated futures exchange, and on ICE, an unregulated OTC exchange. As a regulated exchange, NYMEX was required to monitor Amaranth's trading and prevent Amaranth's holdings from becoming too large. As an exempted OTC exchange, ICE shared no such responsibility and made no attempt to limit Amaranth's speculative trading.

On numerous occasions in 2006, Amaranth exceeded NYMEX accountability levels and CFTC position limits for natural gas contracts. In August, NYMEX finally took action and directed Amaranth to reduce its holdings in the natural gas futures contracts for September and October. Amaranth complied with NYMEX's order and, by the end of the month, had exited its positions in the two contracts. Rather than reducing its overall natural gas holdings, however, Amaranth simply shifted its trading to ICE, where accountability levels and position limits do not apply. Through trades on ICE, Amaranth not only maintained, but actually increased, its positions in September and October natural gas contracts. As a result, NYMEX's instructions did nothing to reduce Amaranth's size, but simply caused Amaranth to move its trading from a regulated market to an unregulated one.

The Amaranth facts demonstrate the need for greater transparency and regulation on electronic, OTC energy exchanges and raise serious concerns regarding the ability of the CFTC to prevent excessive speculation and price manipulation in our energy markets. Speculative energy traders should not be able to skirt CFTC oversight by simply shifting their positions to unregulated, electronic energy exchanges. Yet, that is exactly what our current regulatory structure allows.

Amaranth's collapse revealed a troubling level of high-risk, speculative trading that occurs on U.S. energy markets. Indeed, more than 500 energy-related hedge funds deploy a combined \$67 billion in speculative capital to our energy markets. These traders bring important liquidity and vitality to the markets in which they invest. At the same time, however, we must ensure that speculative capital does not overwhelm the real buyers and sellers, like utilities and industrial users of natural gas. More than ever before, it is imperative that the CFTC and other market regulators have the statutory authority and budget necessary to police our energy markets.

Despite this pressing need for oversight, the CFTC's ability to conduct market surveillance has been eroded; its ability to prevent excessive speculation and price manipulation has been diminished. This is a direct result of the fact that more and more energy trading takes place on unregulated, electronic, OTC exchanges. I am concerned that incomplete information and inadequate authority make it difficult, if not impossible, for the CFTC to effectively monitor and prevent excessive speculation and price manipulation in our energy markets.

As we move forward, however, we must not overlook the fact that, like the traders who use them, electronic, OTC exchanges have brought increased competition and liquidity to our energy markets. Nor should we overlook the fact that, in many cases, these exchanges offer far greater transparency to both traders and regulators than do other OTC markets. For example, pursuant to its "special call authority," the CFTC now receives significant market disclosures from ICE, including position reports for all traders of certain natural gas contracts. The enhanced transparency offered by ICE's comprehensive position reports is in stark contrast to the opaque off-exchange, OTC market, where there are not only no position limits, but also, no reporting requirements.

Therefore, as we noted in the Minority's Views on the Subcommittee's Report, Congress must ensure that any proposed cure is not worse than the disease. If we extend CFTC oversight and regulation to electronic, over-the-counter exchanges, we must avoid unintended consequences – namely, creating incentives for the exchanges themselves to move to less regulated commodities markets offshore. Moreover, we must avoid creating incentives for traders to shift their business to far less transparent and unregulated OTC markets. This is a real concern. In fact, according to a recent piece from Dow Jones, there has been a “recent groundswell in off-exchange transactions” and “hundreds of little-known, under-the-radar brokerage shops ... are fast gaining currency – and notoriety – in energy-trading strongholds.”

I look forward to hearing the testimony from today's witnesses. I again thank the Chairman for leading this important bipartisan effort.