



Commodity Futures Trading Commission

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Remarks

Remarks of General Counsel Terry Arbit Before the Energy Markets Advisory Committee

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Good afternoon, and thank you for the opportunity to appear here today. With the recent dramatic increases in crude oil futures prices, on May 29 the Commission announced a series of energy market initiatives to improve oversight of the energy futures markets. I have been asked to briefly identify these important Commission initiatives.

The first set of measures will provide for enhanced cross-border surveillance information sharing for crude oil trading through an agreement that the Commission has reached with the United Kingdom's Financial Services Authority (FSA) and the ICE Futures Europe exchange. Before describing this agreement, though, let me first provide some legal and historical background. Section 4(a) of the Commodity Exchange Act (Act) generally requires that all futures trading be done on designated contract markets. But it also contains an exception for futures contracts listed for trading on a board of trade that is "located outside the United States," so that U.S. persons under appropriate circumstances can trade these futures contracts. In Section 4(b) of the Act, Congress has provided that the Commission may not adopt rules or regulations that govern any rule, contract term or action of a foreign board of trade.

During the past two decades, several foreign boards of trade have sought permission to place computer terminals in this country to permit direct electronic access to the foreign exchange by U.S. persons. The legal question raised by such requests is whether a particular foreign board of trade with trading terminals in this country is "located outside the United States" so that it need not become a designated contract market? This has proved to be quite a vexing question, and has prompted extensive debate over the years. The concern has been voiced that a definition of an exchange's "location" that is cast too broadly could obstruct the development of global futures trading by subjecting exchanges to duplicative and inconsistent regulatory requirements.

Having received voluminous public comments and held prior public forums on this topic, the Commission has permitted foreign boards of trade to place direct access trading

screens in the U.S. pursuant to the issuance of staff “no-action” letters, but only: 1) if Commission staff has determined that the foreign board of trade is a bona fide exchange and that the exchange and its regulator abide by comparable regulatory objectives; and 2) subject to a number of significant conditions, such as information-sharing. This process is consistent with the Commission’s historical leadership in developing international regulatory networks, increasing international cooperation, and promoting responsible innovation and fair competition in the face of increasing globalization – all the while maintaining vigilant oversight of the U.S. futures markets.

It also proved to be consistent with the intent of Congress as subsequently expressed in Section 126 of the Commodity Futures Modernization Act of 2000 (CFMA).^{*} There, Congress found, among other things, that “regulatory impediments to the operation of global business interests can compromise the competitiveness of United States businesses.” The CFMA also included the Sense of the Congress that the Commission should encourage, among other things: 1) the facilitation of cross-border transactions through the removal or lessening of any unnecessary legal or practical obstacles; 2) the enhancement of international supervisory cooperation; 3) the strengthening of international cooperation for customer and market protection; and

4) improvements in the quality and timeliness of international information sharing.

Two years ago, in 2006, ICE Futures Europe listed three cash-settled energy futures contracts that were linked to the settlement price of competing futures contracts traded on the New York Mercantile Exchange (NYMEX); of the three, the one that has developed the most significant liquidity is the West Texas Intermediate (WTI) crude oil contract. Even though the ICE Futures Europe WTI contract is not physically settled, the Commission was concerned about the contract’s possible effects on U.S. markets. Specifically, the Commission and its surveillance staff were concerned that we would not be able to observe the entirety of a trader’s position in both markets, which would increase the possibility of trading abuses. This concern was heightened when ICE Futures Europe allowed U.S. persons to directly trade this product through terminals in this country pursuant to a previously-granted staff no-action letter.

Accordingly, the Commission undertook a transparent process, including a public hearing, to evaluate its approach to foreign boards of trade that seek to place direct access terminals in the U.S. As a result, a unanimous Commission published a Statement of Policy in November 2006[†] which affirmed its existing process with respect to such foreign boards of trade, but significantly, also added certain enhancements to ensure, among other things, proper cross-border information sharing by regulatory authorities necessary for the Commission to carry out its regulatory responsibilities.

Pursuant to the Statement of Policy, the Commission shortly thereafter entered into a Memorandum of Understanding with the FSA which established a framework for the sharing of information that each regulator needs to detect abusive or manipulative trading practices in these related futures contracts. Since 2006, the FSA has provided the Commission with weekly trader information, and daily information in the final trading

^{*} Appendix E of P.L. No. 106-554, 114 Stat. 2763 (2000).

[†] 71 Fed. Reg. 64443 (November 2, 2006).

week, to facilitate oversight of trading in the linked WTI contracts traded on NYMEX and ICE Futures Europe.

As envisioned by the Memorandum of Understanding, the Commission and the FSA continually review the oversight framework, with a view to making changes where regulatory oversight of these markets can be enhanced. Two weeks ago, the Commission and the FSA agreed upon expanded information-sharing for surveillance of the WTI futures contracts that trade on both NYMEX and ICE Futures Europe. This agreement includes: 1) immediate implementation of expanded information-sharing to provide the Commission with daily large trader positions in the ICE Futures Europe WTI crude oil contract; 2) extending trader information sharing to provide crude oil large trader position data for all contract months in the WTI contract, not just the nearby months; 3) a commitment to enhance trader information to permit more detailed identification of market end users; 4) a commitment to provide improved data formatting so trading information can be seamlessly integrated into the Commission's surveillance system; and 5) in addition to the established position management program that the FSA currently requires, ICE Futures Europe will notify the Commission when traders exceed position accountability levels, as established by U.S. exchanges, for WTI crude oil contracts.

But the Commission's recent energy market initiatives do not address foreign boards of trade alone, as they also include three steps to increase transparency of trading in U.S. energy markets. First, to improve transparency for energy market index trading activity, the Commission will use its existing Special Call authorities to immediately begin requiring traders in the energy markets to provide the agency with monthly reports of their index trading. Second, the Commission will develop a proposal to routinely require more detailed information from index traders and swap dealers in the futures markets, and review whether classification of these types of traders can be improved for regulatory and reporting purposes. Third, the Commission will review the trading practices for index traders in the futures markets to ensure that this type of trading activity is not adversely impacting the price discovery process, and to determine whether different practices should be employed.*

It is not surprising that the creativity and innovation in the futures markets over the past decade, especially when coupled with the drive toward globalization, have raised new regulatory challenges such as linked contracts across the oceans, and increased index trading activity. As reflected in these important energy market initiatives, the Commission is committed to obtaining the information, and providing the transparency, that is necessary to ensure effective oversight that will keep the energy futures markets responsive to fundamental economic forces of supply and demand, and free from fraud, manipulation, and other trading abuses.

This concludes my remarks. Thank you very much.

* Finally, the Commission's recent initiatives also included the disclosure that in December 2007, the agency's Division of Enforcement launched a nationwide crude oil investigation into practices surrounding the purchase, transportation, storage, and trading of crude oil and related derivatives contracts. The Commission took the extraordinary step of disclosing this investigation because of today's unprecedented market conditions.