Statement of
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Before the
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Farm Commodities and Risk Management

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I am Terrence Duffy, Executive Chairman of Chicago Mercantile Exchange Group, Inc., ("CME Group" or "CME"). Thank you Chairman Etheridge and members of the Subcommittee for this opportunity to appear here today to present our views on our markets and the role of speculators in those markets. 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 serve the global risk management needs of our customers and those who rely on price discovery provided by the competitive markets maintained by the Exchanges. 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. Additionally, we offer order routing, execution and clearing services to other exchanges by means of our Globex® electronic trading platform and our clearing house. CME Group is traded on the New York Stock Exchange and NASDAQ under the symbol "CME."

Walter Lukken, the acting Chairman of the CFTC, the Commission's economists and its enforcement staff – along with the economists, surveillance staff of the CME and CBOT – have carefully examined whether speculative trading on futures markets is exacerbating commodity prices. In testimony before the Senate Appropriations Subcommittee on Financial Services and General Government, Chairman Lukken provided a concise summary of the issue. He said: "These are extraordinary times for our markets with commodity futures prices at unprecedented levels. In the last three months, the agricultural staples of wheat, corn, soybeans, rice and oats have hit all-time highs. We have also witnessed record prices in crude oil, gasoline and other related energy products. Broadly speaking, the falling dollar, strong demand from the emerging world economies, global political unrest, detrimental weather and ethanol mandates have driven up commodity futures prices across-the-board. On top of these trends, the emergence of the sub-prime crisis last summer led investors to increasingly seek portfolio exposure in commodity futures. . . .To date, CFTC staff analysis indicates that the current higher futures prices generally are not a result of manipulative forces."[1]

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 . . . ."[2]

The U.S. Department of Agriculture's Economic Research Service recently studied the causes of increases in food commodity prices and concluded that, in addition to slower growth in production compared with rapid growth in demand, "…factors that have added to global food commodity price inflation include the declining value of the U.S. dollar, rising energy prices, increasing agricultural costs of production, growing foreign exchange holdings by major food-importing countries, and policies adopted recently by some exporting and importing countries to mitigate their own food price inflation."

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[1] Oral Testimony of Walter L. Lukken, Acting Chairman, Commodity Futures Trading Commission Before the United States Senate Subcommittee on Financial Services and General Government Committee on Appropriations May 7, 2008 at http://www.cftc.gov/stellent/groups/public/@newsroom/documents/speechandtestimony/opalukken-39.pdf.

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

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."

In short, the traditional production/consumption cycle that has governed prices in commodity markets is under stress from the confluence of a number of factors.

We have identified eight of the most significant factors that are influencing the supply and demand for grains and oilseeds. Each is important and deserves attention.

1. Biofuels;
2. Limited Farmland;
3. Weak Dollar;
4. Slower Growth in Production vs. Rapid Growth in Demand;
5. Additional Meat Needs More Grain
6. Drought;
7. Export Curb; and
8. Inventories

These critical factors combine to create volatile markets and increased prices. They are also driving structural change of unprecedented scope in the commodity markets.

1. 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 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. Add to that the 2005 energy bill in the U.S. that 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%.

As we can see from this discussion, it is not just the supply side of the equation driving volatility in commodity markets any longer but unprecedented demand is starting to play a much larger role.

2. Limited Farmland

Farmers are intelligent and economically rational. Last year, farmers planted the most land to corn since 1944 as demand from the ethanol sector boosted prices. This year, farmers are forecast to raise their soybean seedings by about 18 percent to 75 million acres. To do this they will plant less corn: only 86 million acres compared to 94 million in 2007.

3. Weak Dollar

Since 2000, the dollar has depreciated by 28% as measured by the U.S. Dollar Index, which is comprised of six major currencies (Euro, Japanese Yen, British Pound, Canadian Dollar, Swedish Krona, and Swiss Franc). This decline in the value of the dollar, which is the currency in which international grain trade is conducted, means that commodity prices are, on average, 28% lower for these importers than they would be if the value of the dollar had remained constant during this period.

CME Group is also committed to redoubling its efforts to educate the banking community on hedging, and we have held discussions with the National Grain and Feed Association (NGFA) on jointly devising and implementing this new program. Too often we have discovered that many in the banking community do not fully understand the hedging of commodities

and as a result, are reluctant to extend credit when markets are volatile. We believe better understanding of hedging by bankers, while not likely to solve the credit crisis in agriculture, will certainly help the situation. In a few weeks, we'll kick off this effort with a seminar for Co-Bank employees from their regional offices in Denver, Kansas City and Omaha.

We will continue to review ways in which we may deliver some form of relief to hedgers who are experiencing difficulty with margin financing. We firmly believe that some of the restrictions currently imposed upon us relative to new product creation need to be reviewed. We believe that more creative product development in exchange-cleared OTC products may be one of many innovative solutions that should be allowed to address today's challenges.

4. Slower Growth in Production vs. Rapid Growth in Demand

The average annual growth rate in the production of grains and oilseeds has slowed from 2.2 percent per year in the 1970s and 80s to only 1.3 percent since 1990. USDA projects further declines in the next 10 years.

5. Additional Meat Needs More Grain

As the demand for meat rises, especially from fast-developing countries like China and India, the demand for grain and protein feeds grows at an even faster rate. In the short-run, GDP 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.

6. Drought

Multi- and single year droughts in Australia, the Black Sea states, Russia and Canada reduced wheat, barley and rapeseed production.

7. Export Curbs

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, and announced a sliding scale export tax 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.

Recently, The Financial Times quoted the UN Food and Agricultural Organization statistics stating that global imports of wheat from the period 2004/5 to 2007/8 increased by 91.7%.

According to the U.S. Soybean Export Council, there are over 14 countries that have just recently placed some form of higher tariff or an outright curb on grain exports.

8. Inventories

U.S. wheat surplus stocks are forecast to be the lowest in 60 years, and global wheat stocks are forecast to be the lowest in 30 years.

While the composition of our markets has not changed significantly in recent years, we are still cognizant of the need to ensure that our markets are performing well for our traditional market participants. As such, we want to proceed with prudence before deciding upon any changes to contract design or policies that may affect the current profiles of market users.

The CFTC requires that any changes we make to our contracts that could affect prices or price relationships be implemented beyond open interest or at the beginning of new crop years. Thus, we cannot make snap changes to our contracts. This is actually a positive rule as even a well functioning market will occasionally react unexpectedly to some market events. Our task is to provide a liquid and orderly market. This requires that we do no harm to a market by reacting too quickly – in effect, the prudent man rule. That said, when we gain solid evidence that a contract is not performing, we react quickly and decisively. Recall, as an example, the river delivery terms for corn and soybeans implemented in 1999.

We have worked with a broad spectrum of our customers to establish several contract changes that will be taking effect soon. They will, we believe, improve market performance. Storage charges will increase for wheat, beginning with the July 08 contract; storage charges will increase for corn, beginning with the December 08 contract; and storage charges will increase for soybeans, beginning with the November 08 contract. Also, in July of this year, the wheat delivery instrument will be changed from a warehouse receipt to a shipping certificate. This will expand the effective storage capacity of the wheat contract and improve convergence in the wheat market. We also have proposed increases to the corn and soybean load-out charges to better reflect the increased cost of elevation in the cash markets. All of these changes have been established through close working relationships with our customers.

We have made the following recommendations to the CFTC regarding participation in the grain and oilseed markets by non-traditional investors:

- We have requested that the CFTC defer consideration of increases in federal speculative position limits until additional analysis is completed – examining at the impact of increased limits upon the grain futures market performance.

- We also recommend that consideration by the CFTC of a new risk management exemption for passive investors be extended for a period of six to nine months while additional analysis of these proposed new regulations is conducted.

Additionally, we call on the CFTC to act as soon as possible to lift the prohibition on clearing of agricultural swaps products traded in the OTC market. We believe that lifting these restrictions will stimulate innovation in this sector that could help commercial firms better manage their price risk in the current challenging market environment.

We need to monitor global events, whether natural or government induced, that affect the supply/demand balance in our local markets. The United States serves as the principal provider of grain and oilseeds to the world. As such, our country represents the primary market for price discovery and risk management for the global grain and oil seed marketplace. We at CME Group work in close coordination with our customers and the CFTC to help ensure that our grain and oilseed markets continue to function effectively as we build for the future.

None of these factors seems to make the least impression on those commentators who demand an easy solution, which they claim can be mandated without cost or consequence. This vocal group, which does not include any competent agriculture economists, insists that driving speculators from the markets will bring prices back to a level that is more acceptable to these critics and better for the market. Worse still, the plan is to drive speculators from futures markets by government mandated increases in margins.

The proponents of this plan do not understand the role of speculation. They do not understand that there are speculators on both sides of the market. They fail to grasp that increasing margins to artificial levels is just as likely to drive prices to artificial levels. And they are oblivious to the fact that efforts to mandate price by direct price control, or by indirect actions, distort future production and cause costly misallocation of resources of production.

The imposition of artificially high performance bonds ("margins") will drive users away from transparent, regulated futures markets and into opaque, unregulated OTC markets. These OTC markets have less liquidity, less price transparency and no public accounting for traders' positions. This is a net loss to the objective of fair, efficient, transparent and well-functioning commodity and energy markets.

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 commodity and energy futures markets. Moreover, it would interfere with the prudential risk management practices of central counterparty clearing houses.

Our extensive market regulation experience – and our experience with previous external efforts to control commodity prices by means of adjusting the level of performance bonds – has established that artificially increasing margins is neither effective nor responsible. Furthermore, there is no evidence that artificially increasing performance bonds 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. Congress should be skeptical of critics who argue to the contrary.

We look forward to working with Congress to educate the public as to the real drivers of price volatility and inflation and to create a sensible solution.