Commodity Futures Trading Commission

Report on the Oversight of Trading on Regulated Futures Exchanges and Exempt Commercial markets

October 2007

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I. Executive Summary

On September 18, 2007, the Commodity Futures Trading Commission (CFTC or Commission) held a hearing to examine the oversight of trading on regulated futures exchanges (designated contract markets or DCMs) and exempt commercial markets (ECMs). Witnesses included Commission staff, representatives of DCMs and ECMs, and representatives of a broad spectrum of market users and consumers.

ECMs came into being through the Commodity Futures Modernization Act of 2000 (CFMA), which amended the Commodity Exchange Act (CEA or Act) and replaced the "one-size-fits-all" supervisory framework for futures trading with a risk-based, tiered structure in which the level of regulation is tailored to the type of market and the risks associated with it. While there are small start-up ECMs, some ECMs have taken on the characteristics of DCMs. Of particular note to Commission staff is the development by the InterContinental Exchange (ICE) of a "look-alike" natural gas contract with a settlement price linked to the settlement price of the New York Mercantile Exchange (NYMEX) natural gas benchmark futures contract. Such linkage increases the possibility that the ECM contract is serving a significant price discovery role and could provide incentive to manipulate the settlement price of the DCM contract.

The Commission's hearing focused on a number of issues, including the tiered regulatory approach of the CFMA and whether this risk-based model is beneficial; the similarities and differences between ECMs and DCMs; the associated regulatory risks of each market category; the types of regulatory or legislative changes that may be appropriate to address identified risks; and the impact that regulatory or legislative changes might have on the U.S. futures industry and the global competitiveness of the U.S. financial industry.

While many testified that the tiered regulatory structure of the CFMA was successful and should not be eliminated, witnesses also described concerns associated with the current regulatory structure governing ECMs and the regulatory disparity between DCMs and ECMs. Witnesses raised concern that this disparity increased the susceptibility of the markets to manipulation and disadvantaged the competitive posture of regulated exchanges that offer virtually identical products. Generally, most witnesses believed that some changes to the ECM provisions may be appropriate, as long as they are prudently targeted and do not adversely affect the ability of established ECMs to innovate and grow.

Based upon the hearing and its experience and expertise in these areas, the Commission finds that the risk-based, tiered approach has operated effectively. ECMs have proven popular for new start-up markets and have provided competition for DCMs, spurring them toward innovations of their own.

To the extent that trading volume on an ECM contract remains low and its prices are not significantly relied upon by other markets, the current level of regulation is appropriate. When an ECM contract matures and begins to serve a significant price discovery function for transactions in commodities in interstate commerce, the futures contract warrants some increased oversight to deter and prevent price manipulation or other disruptions to market integrity. This also will help to ensure "fair competition" among certain ECMs and DCMs that are trading similar products and are vying for the same business.

Based upon the foregoing, the Commission recommends the following legislative changes for ECM contracts that are determined to serve a significant price discovery function:

1. **Large Trader Position Reporting** - An ECM contract that is determined to serve a significant price discovery function should be subject to large trader position reporting requirements comparable to those that currently apply to all DCM contracts. A large trader reporting system would enable the Commission's market surveillance staff to monitor positions on a daily basis to detect and deter possible manipulative schemes.

2. **Position Limits and/or Accountability Level Regime** - An ECM should be required to adopt position limits or accountability levels, as appropriate, for a listed contract that serves a significant price discovery function similar to the limits on DCMs.

3. **Self Regulatory Oversight** - An ECM should be required to monitor trading of a listed contract that serves a significant price discovery function to detect and prevent manipulation, price distortion, and disruptions of the delivery or cash-settlement process.

4. **Emergency Authority** - The Commission and ECM should be provided with emergency authority to alter or supplement contract rules, liquidate open positions, and suspend or curtail trading in any listed contract that serves a significant price discovery function. These authorities would be essential tools for the Commission and an ECM to prevent manipulation and disruptions of the delivery or cash-settlement process.

The determination of whether an ECM contract serves a significant price discovery function should focus on the following factors: (1) *Material Liquidity* - trading volume in the ECM contract must be significant enough to affect regulated markets or to become a pricing benchmark; and (2) *Linkage/Material Price Reference* - the relevant ECM contract must either be influencing other markets and transactions through this linkage or be materially referenced by others in interstate commerce on a frequent and recurring basis.

In addition, to promote greater understanding of trading in energy futures products, the Commission intends to: (1) establish an Energy Markets Advisory Committee to conduct public meetings on issues affecting energy producers, distributors, market users and consumers; and (2) work closely with the Federal Energy Regulatory Commission (FERC) to educate and develop best practices for utilities and others who use NYMEX settlement prices as hedging vehicles and benchmarks in pricing their energy products.

II. Hearing Participants

CFTC Commissioners

- Walter L. Lukken – Acting Chairman
- Michael V. Dunn – Commissioner
- Jill E. Sommers – Commissioner
- Bartholomew H. Chilton – Commissioner

Panel I – CFTC Staff Witnesses

- Terry S. Arbit – General Counsel
- John F. Fenton – Deputy Director for Market Surveillance, Division of Market Oversight
- Jeffrey H. Harris – Chief Economist
- Richard A. Shilts – Director, Division of Market Oversight

Panel II – Trading Facilities

- Craig S. Donohue – Chief Executive Officer and Director, CME Group, Inc.
- Peter Krenkel – President, Natural Gas Exchange, Inc.
- James E. Newsome – President and Chief Executive Officer, New York Mercantile Exchange
- Richard L. Sandor – Chairman and Chief Executive Officer, Chicago Climate Exchange
- Jeffrey C. Sprecher – Chairman and Chief Executive Officer, InterContinental Exchange, Inc.

Panel III – Market Users

- Laura Campbell – Assistant Manager for Energy Resources, Memphis Light Gas & Water; Member, American Public Gas Association
- John M. Damgard – President, Futures Industry Association
- R. “Skip” Horvath – President, The Natural Gas Supply Association
- Russ Stolle – Senior Vice President, Global Public Affairs and Communication, Huntsman Corporation

Panel IV – Market Users

- Mark Cooper – Director of Research, Consumer Federation of America
- Sean Cota – President, Cota & Cota, Inc.; President, New England Fuel Institute; Northeast Chair, Petroleum Marketers Association of America
- John G. Gaine – President, Managed Funds Association
- Greg Zerzan – Counsel and Head of Global Public Policy, International Swaps and Derivatives Association, Inc.

III. Introduction

On September 18, 2007, the Commodity Futures Trading Commission (CFTC or Commission) held a hearing to examine the oversight of trading on regulated futures exchanges (DCMs) and exempt commercial markets (ECMs).[1] An ECM is a relatively new type of derivatives market that came into being by virtue of the provisions of the Commodity Futures Modernization Act of 2000 (CFMA). Although ECMs are subject to certain recordkeeping and reporting requirements, as well as the anti-fraud and anti-manipulation provisions of the Commodity Exchange Act (CEA or Act), they are not considered to be "regulated" markets.[2]

The Commission's review of trading on ECMs was prompted by several factors. One consideration was that nearly seven years have passed since adoption of the CFMA. Over this period, derivatives markets generally, and ECMs in particular, have continued to grow and evolve. Thus, the Commission determined that it was appropriate to review and evaluate how well the Act's ECM provisions are functioning and whether any adjustments may be needed. In addition, recent energy market volatility has raised questions regarding the role that trading on ECMs plays in these vital markets.[3] Concerns among lawmakers regarding energy markets have prompted a number of legislative proposals currently pending before Congress that would amend the Act's ECM provisions. In addition, the anticipated introduction of CFTC reauthorization legislation, which may also include amendments to the Act's ECM provisions, provides an opportunity for the Commission to weigh in on this important topic. As such, the Commission's review and report is intended to inform this debate in Congress.

Witnesses at the hearing included Commission staff, representatives of DCMs and ECMs, and representatives of a broad spectrum of market users and consumer groups. This report provides information regarding the relevant regulatory structure, reviews the testimony given at the hearing, and presents the Commission's findings and recommendations based on the hearing testimony and the Commission's expertise and experience administering the Act.

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[1] In lieu of attaching lengthy appendices to this report, the Commission has posted a transcript of the hearing, copies of the witnesses' written statements and exhibits, and other relevant background materials on its website at http://www.cftc.gov/newsroom/cftcevents/2007/event091807.html.

[2] *See* 7 U.S.C. § 2(h)(5)(F) (prohibiting ECMs from representing that they are registered with, designated, recognized, licensed, or approved by the Commission).

[3] *See e.g.*, The Role of Market Speculation in Rising Oil and Gas Prices: A Need to Put the Cop Back on the Beat, Staff Report by the Permanent Subcommittee on Investigations of the Senate Committee on Homeland Security and Government Affairs, 109th Cong, 2nd Sess., June 27, 2007.

IV. Background

A. Statutory and Regulatory Requirements

1. Risk-Based, Multi-Tiered Approach to Regulation

The CFMA amended the Act to replace the historical "one-size-fits-all" supervisory framework for futures trading with a risk-based statutory structure in which the level of regulation is tailored to the type of market and the risks associated with that market. Based on recommendations from a report of the President's Working Group on Financial Markets (PWG)[4], the CFMA also provided much-needed legal certainty to the burgeoning over-the-counter (OTC) markets by creating statutory exclusions and exemptions from regulation for swaps and other OTC derivatives. The new framework was intended to create a regulatory environment that would promote continued growth and innovation in both the exchange and OTC derivatives markets and foster competition in a rapidly changing global marketplace.

Drawing from the Commission's "New Regulatory Framework," which was finalized just prior to the enactment of the CFMA[5], Congress codified in the CFMA a multi-tiered market framework in which the level of oversight applied is based primarily on the nature of the commodity being traded and the participants who are trading. In general, where access to a trading facility is restricted to more sophisticated traders or commercial participants, or where the type of commodity being traded poses a relatively low risk of susceptibility to manipulation, regulatory oversight is reduced to reflect the reduced need for supervision of that market. Markets with unrestricted commodity offerings open to all types of participants (DCMs) are subject to the highest level of regulatory oversight. 7 U.S.C. §§ 7, *et seq.*

The CFMA also created an exchange category called a derivatives transaction execution facility (DTEF). 7 U.S.C. §§ 7a, *et seq.* There are two types of DTEF – retail and commercial. DTEFs have fewer regulatory requirements than those for DCMs, but are subject to differing limitations on eligible traders and the commodities that may be traded. Although subject to a lighter regulatory regime than the DCM, the DTEFs must have compliance and surveillance programs, and must undertake significant self-regulatory responsibilities, including establishing and enforcing rules to deter trading abuses and monitoring the market to ensure orderly trading.[6]

A third market category created by the CFMA is the exempt board of trade (EBOT). 7 U.S.C. §§ 7a-3, *et seq.* Unlike DCMs and DTEFs, EBOTs are not registered with, or designated by, the Commission. EBOTs are exempt from most provisions of the CEA (other than its anti-fraud and anti-manipulation prohibitions), but are subject to certain commodity and participant restrictions.

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[4] *Over-the-Counter Derivatives Markets and the Commodity Exchange Act,* Report of the President's Working Group on Financial Markets, November 1999.

[5] *See A New Regulatory Framework for Multilateral Transaction Execution Facilities, Intermediaries and Clearing Organizations,* 65 Fed. Reg. 77962 (CFTC December 13, 2000) (adopting final rules); and 65 Fed. Reg. 82272 (CFTC December 28, 2000) (withdrawing final rules to determine their compatibility with the CFMA).

[6] To date, no trading facility has applied to the Commission to register as a DTEF.

Specifically, the commodities that can be traded on an EBOT are those defined as "excluded commodities," such as an interest rate, exchange rate, credit risk or measure, debt, measure of inflation or other macroeconomic index or measure. 7 U.S.C. § 1a(13). EBOTs must limit access to certain institutional and sophisticated persons defined as "eligible contract participants." 7 U.S.C. § 1a(12).[7]

In addition to creating three new market categories, the CFMA created several exclusions from regulation for certain swaps and other derivatives traded OTC on a bilateral basis.[8] These provisions reflected the view, consistent with the PWG report and various Congressional and Commission actions during the preceding decade, that off-exchange transactions for certain commodities between sophisticated counterparties do not necessarily require the full weight of the protections that the CEA provides for transactions executed on DCMs.[9]

Finally, the CFMA provided a separate exemption for transactions executed on ECMs under section 2(h) of the Act. 7 U.S.C. §§ 2(h)(3)-(5).[10] This exemption retains for the CFTC certain residual authorities over these transactions. To qualify for the ECM exemption, the transactions are required to be executed on electronic trading facilities on which multiple persons have the ability to trade contracts by accepting bids and offers from multiple other participants. The commodities eligible to be traded on an ECM are limited to "exempt commodities," which exclude agricultural and financial products but include primarily energy, metals, chemicals, and emission allowances. 7 U.S.C. § 1a(14). Under this exemption, ECMs must limit access to a

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[7] The term "eligible contract participant" (ECP) refers to institutional and highly accredited participants such as, among others, financial institutions, registered investment companies, corporations, partnerships, trusts, and individuals having total assets exceeding $10,000,000.

[8] For example, Section 2(g) created an exclusion from the CEA for swaps entered into between ECPs. 7 U.S.C. § 2(g). Similarly excluded are transactions between ECPs involving excluded commodities that are not executed on a trading facility. 7 U.S.C. § 2(d)(1). As pertains to energy commodities, where manipulation can be a concern, CEA Section 2(h)(1) provides that bilateral energy transactions entered into between certain defined commercial entities are exempt from the CEA, except for the CEA's anti-fraud and anti-manipulation prohibitions. 7 U.S.C. § 2(h)(1).

[9] *See e.g.*, *Policy Statement Concerning Swap Transactions*, 54 Fed. Reg. 30,694 (CFTC July 21, 1989) (stating that "at this time most swap transactions, although possessing elements of futures or options contracts, are not appropriately regulated as such under the CEA.…"); *Exemption for Certain Contracts Involving Energy Products*, 58 Fed. Reg. 21286 (CFTC April 20, 1993) (granting an exemption for certain contracts involving covered energy products entered into between commercial participants) ("Energy Exemption"). The Energy Exemption was part of a series of Commission orders issued pursuant to the Futures Trading Practices Act of 1992, which provided the Commission with explicit exemptive authority to be utilized as "a means of providing certainty and stability to existing and emerging markets so that financial innovation and market development can proceed in an effective and competitive manner." H. Rep. No. 102-978, 102d Cong., 2d Sess. at 81 (1992).

[10] The current language of Section 2(h) initially passed the House of Representatives on October 19, 2000 by a vote of 377-4 (146 CR H10411, October 19, 2000) with a Statement of Administrative Policy in support of the legislation. This identical language was again passed as part of the CFMA in HR 4577 by both the House and the Senate on December 14 and 15, 2000, respectively (146 CR H2181, December 14, 2000 and 146 CR S11866, December 15, 2000).

subset of ECPs defined as "eligible commercial entities" (ECEs) that trade on their own behalf. 7 U.S.C. § 1a(11).[11]

Because ECMs are trading facilities where commercial and sophisticated entities, on a principal-to-principal basis, come together to trade commodities where manipulation can be a concern, they occupy their own niche in the risk-based, multi-tiered spectrum of regulation under the Act. As such, they are subject to greater regulatory requirements than EBOTs or bilateral OTC transactions, yet are not regulated to the same degree as DCMs or DTEFs.

2. Regulatory Requirements for ECMs

ECMs are subject to certain recordkeeping and reporting requirements under the CEA. For example, an ECM must maintain for five years, and make available for inspection upon request by the Commission, records of its activities related to its business as a trading facility. 7 U.S.C. § 2(h)(5)(B)(ii). More specifically, under Commission Rule 36.3, an ECM must identify to the Commission those transactions for which it intends to rely on the exemption in § 2(h)(3) of the Act and which averaged five trades per day or more over the most recent calendar quarter. For all such transactions, the ECM must provide to the Commission weekly reports showing certain basic trading information, or provide the Commission with electronic access that would allow the Commission to compile the same information. 17 C.F.R. § 36.3.

An ECM must also provide to the Commission, upon special call, any information relating to its business that the Commission determines is appropriate to enforce the anti-fraud and anti-manipulation provisions of the CEA, to evaluate a systemic market event, or to obtain information on behalf of another federal financial regulator. 7 U.S.C. § 2(h)(5)(B)(iii). Commission staff has issued several special calls to the InterContinental Exchange, an ECM generally referred to as "ICE" (discussed *infra*, section IV(D)(3)).

Finally, an ECM must also maintain a record of any allegations or complaints it receives concerning suspected fraud or manipulation, and provide the Commission with a copy of the record of each complaint that alleges facts that would constitute a violation of the CEA or Commission Regulations. 17 C.F.R. § 36.3.

3. Differences Between ECMs and DCMs

Though ECMs are subject to the foregoing regulatory requirements, the CEA does not subject them to the level of transparency and Commission oversight associated with DCMs. DCMs must satisfy specified criteria to become designated, and then must demonstrate compliance with core principles on a continuing basis. While the CEA provides flexibility in how DCMs choose to comply with the core principles, the core principles mandate that DCMs undertake significant supervisory responsibility with respect to trading on their markets. For example, DCMs may list for trading only those contracts that are not readily susceptible to manipulation and must have

[11] ECE refers to, among others, an entity that has a demonstrable ability to make or take delivery of an underlying commodity, incurs risks related to the commodity, or is a dealer that regularly provides risk management, hedging services, or market-making activities. ECEs can be funds, but cannot be individuals.

rules and procedures for preventing market manipulation. Further, DCMs are required to adopt position limit or accountability rules, where necessary and appropriate, in order to address the potential for market manipulation or congestion. DCMs also must have compliance and surveillance programs, which the Commission evaluates through its rule enforcement reviews.

These statutory requirements do not apply to ECMs. The CEA does not require ECMs to monitor trading on their markets. Nor does the CEA provide the Commission with emergency authority over ECMs in order to force a reduction or liquidation of positions, or alter or supplement trading rules. The Commission has this authority over DCMs.

The CEA gives the Commission the authority to determine whether an ECM contract performs a significant price discovery function for transactions in an underlying cash market. Such a determination, however, does not trigger any self-regulatory responsibilities for the ECM, or additional oversight authority for the Commission, akin to that existing for DCMs. The determination triggers only an obligation by the ECM to publicly disseminate certain specified information such as contract terms and conditions, trading volume, open interest, and opening and closing prices or price ranges. 7 U.S.C. § 2(h)(4)(D); 17 C.F.R. §36.3.

B. Evolution of ECMs Since 2000

The first ECMs that notified the Commission of their intent to operate generally were simple trading platforms, resembling in many ways business-to-business facilities for large commercial firms. Their key role was to facilitate the execution of trades between commercial counterparties by offering an anonymous and efficient electronic matching system believed to be superior to the existing voice broker system, and to provide for a competitive advantage in the bilateral OTC market, especially for energy products.

Initially, most ECMs were relatively small operations and their trading volumes were small compared to DCMs. The first ECMs did not offer a clearing component – they addressed issues related to the financial integrity of transactions by setting up credit filters that allowed traders to limit their counterparties to a customized list of traders. In addition, the contracts listed on early ECMs were not linked to contracts listed on DCMs and consequently did not affect the Commission's oversight of trading activity on DCMs.

Since 2001, 20 companies have notified the Commission that they intend to operate as ECMs. Many of these companies trade, or plan to trade, energy-related products – mostly natural gas, petroleum products and electricity. The first two facilities to file notices in 2001 were the International Maritime Exchange (Imarex), a Norwegian market, and ICE, located in Atlanta. Currently, eight of the 20 ECMs that filed a notice are active.

Based on CFTC staff interviews of market participants and on testimony given at the September 18 hearing, it appears that for many ECMs, the majority of their business comes from non-regulated institutional traders. Moreover, companies elect to become an ECM rather than a DCM or DTEF largely because of the reduced regulatory burden. ECMs view this reduced regulatory burden as being more amenable to their business operations and goals because becoming an ECM allows a market to expand into electronic trading under a less demanding regulatory scheme. It also appears that markets have not used the ECM category as a stepping stone to eventually become a more regulated exchange, such as a DTEF or a DCM; ECMs have tended to remain ECMs.

During the last few years, there have been a number of changes in the ECM landscape. While some ECMs continue to be small, start-up type ventures, there are ECMs that have taken on some of the characteristics of DCMs. Significantly, five of the eight active ECMs now offer a clearing component that is widely utilized by their participants to obtain an efficient and effective means to manage credit risk.[12] There also have been changes in the types of traders that participate on ECMs, *i.e.*, certain exchange floor brokers and floor traders now are considered ECEs and are able to participate on ECMs subject to certain conditions.[13] Also, ECM trading communities now include many non-commercial traders, such as large hedge funds, which constitute a significant part of the overall activity and open interest in certain ECM contracts.

Although ECMs have been evolving over time to adopt some characteristics of DCMs, the linkage of ECM contract settlement prices to DCM futures contract settlement prices – a relatively recent development – has raised the question of whether the CFTC has the necessary authority to police these markets for manipulation and abuse. The linkage of contract settlement prices was not contemplated at the time of the CFMA nor at the time of the Commission's rulemaking concerning when an ECM contract performs a significant price discovery function. Of special concern to the CFTC staff today is the existence of ECM cash-settled "look-alike" contracts that could provide an incentive to manipulate the settlement price of the underlying DCM futures contract to benefit positions in the "look-alike" ECM contract.

C. Price Discovery on ICE

Utilizing these linked "look-alike" contracts, one ECM in particular, ICE, has become a major trading venue for natural gas in direct competition with the New York Mercantile Exchange (NYMEX) natural gas benchmark futures contract. Based on the comments of many traders and voice brokers, there appears to be an emerging consensus that ICE is a price discovery market for certain natural gas and electricity contracts. In addition, Commission staff has found that the traders on ICE are virtually the same as the traders on NYMEX. All of the top 25 natural gas traders on NYMEX are also significant traders on ICE. ICE's popularity seems to stem from a number of factors, including adequate liquidity and transparency in certain markets, ease of use, and flow-through processing whereby trades are automatically reflected in firms' balance sheets.

For the Henry Hub natural gas market, market participants generally view ICE and NYMEX as essentially a single market and look to both ICE and NYMEX when determining where to execute a trade at the best price. ICE offers a cash-settled contract based on the final settlement

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[12] Amending the law to allow clearing of OTC derivatives was one of the key recommendations made by the PWG Report in 1999.

[13] Among other things, a floor broker or floor trader seeking to qualify as an ECE must be a member of a DCM or have trading privileges on a DCM, and must either be an ECP or have its trades on the ECM guaranteed by a clearing member that is a member of a Commission-registered derivatives clearing organization and is an ECP. 68 FR 2319 (January 16, 2003).

price of the NYMEX Henry Hub physically-delivered contract. In addition, ICE lists a contract that cash-settles based on the final settlement price of the NYMEX Henry Hub natural gas contract on the penultimate day. Lastly, ICE offers a Henry Hub penultimate natural gas option contract. Traders use NYMEX physical and cash-settled contracts as well as ICE Henry Hub look-alike contracts depending on where they can get the best price for liquidity.

D. Economic Analysis of Price Discovery on NYMEX and ICE

The Commission's Office of the Chief Economist (OCE) conducted an empirical study of the relationship of the natural gas contracts that trade on ICE and NYMEX. OCE evaluated price discovery in the natural gas market, viewing price discovery as the process by which new information is incorporated into prices.

When conducting economic analysis of price discovery, a determination that informed traders prefer to trade at one venue over another implies the preferred venue is a price discovery venue. It follows that if venue A is preferred, then price changes there will more likely reflect new information and those changes at venue A should precede changes at venue B. This insight implies that price leadership - that is, a statistical pattern whereby price changes at one exchange precede changes at another exchange - can be interpreted as revealing where price discovery is occurring. Since price leadership can shift between exchanges, it is possible to find that both venues are, at various times, price discovery venues.

Turning to its specific price discovery analysis, OCE collected transaction prices for ICE and NYMEX natural gas contracts from January 3, 2006 through December 31, 2006 and evaluated trading for 20 contract months when trading on each market was appropriately active. OCE examined the timing of price changes on ICE and NYMEX to draw inferences about where information arrives first. If price changes on one venue consistently "led" those on the other venue, then OCE concluded that informed traders preferred trading at that "leading" venue and inferred that market to be "discovering" prices. OCE found that ICE exhibited price leadership with respect to NYMEX on 20 percent of the contract-days, with NYMEX exhibiting price leadership on 63 percent of the contract-days. OCE concluded that these results suggest that, in an economic sense, ICE and NYMEX are both significant price discovery venues for natural gas futures contracts.

As part of OCE's broad analysis of price discovery, OCE first analyzed the mix of hedgers and speculators trading in various markets. The OCE analysis shows that from July 2004 through July 2007 (a period that experienced significant growth in ICE natural gas trading) non-commercial trading (trading by swap dealers and managed money traders) of natural gas futures on NYMEX grew from 42 percent to 52 percent. OCE then compiled similar statistics for active contracts that face minimal ECM competition (corn, heating oil and crude oil). OCE found that the increase in market share by non-commercial traders in natural gas on NYMEX is broadly consistent with similar increases in market share by non-commercial traders in the corn, heating oil and crude oil markets facing minimal ECM competition. Non-commercial trading interest has risen across the board, with both managed money traders and non-reportable trades driving this increase in all markets. In this light, the changing composition of traders in NYMEX natural gas futures trading from 2004-2007 largely represents a market-wide trend toward greater non-commercial trading. As such, OCE concluded that the existence and growth in trading of ICE natural gas contracts does not appear to be a factor in the changing composition of traders in the broader natural gas market.

E. ECMs and Market Surveillance

1. Focus of Commission Surveillance of Energy Markets

The Commission's surveillance of natural gas energy markets focuses on the regulated futures markets at NYMEX. This approach reflects the mandate of the CEA, as DCM contracts are subject to both the CEA reporting requirements that underlie the Commission's large trader reporting system (LTRS) and the statutory provision that enables the Commission to take emergency actions in the case of "threatened or actual market manipulations and corners."[14] By comparison, while natural gas transactions on ECMs are subject to the CEA's anti-manipulation prohibition, they are not subject to these reporting and emergency action provisions. As a result of this disparity, the CFTC surveillance staff finds it increasingly difficult to properly police the regulated markets at NYMEX. To accomplish appropriate surveillance levels, Commission staff needs further transparency into the trading activity on ICE for those contracts linked to NYMEX contracts.

2. Information Received From DCMs

The centerpiece of the Commission's market surveillance program is its LTRS. Under the LTRS, clearing members, futures commission merchants (FCMs), and foreign brokers – collectively called "reporting firms" – file daily reports with the CFTC showing futures and option positions held in accounts they carry that are at or above specific reporting levels set by the CFTC. These reporting levels vary by market, from as low as 25 contracts for small markets to as high as 3,000 contracts. The reporting level for NYMEX natural gas futures markets is 200 contracts. The data provided in these reports in aggregate has covered about 97 percent of total open interest in the NYMEX Henry Hub natural gas contract during the past year.

DCMs are required to provide daily data showing aggregate positions and trading cleared by each clearing member, shown separately for house and individual customer positions. These data include all positions in futures markets at the DCM, but do not reflect the size or identity of customer positions. The Commission also receives large-trader reporting for contracts that are cleared through NYMEX's Clearport facility. Typically, these transactions are executed in the OTC market, through voice brokers, and are then submitted to Clearport for clearing.

In addition, the Commission receives from all DCMs, including NYMEX, daily transaction data, which provide a complete audit trail of all trades that occur in DCM markets. Surveillance staff uses this data to scrutinize trading activity during key trading periods, especially during the closing range of the final trading day.

[14] 7 U.S. C. § 12(a)(9).

Staff from the Commission's Division of Clearing and Intermediary Oversight also uses this trading data to monitor the financial integrity of futures firms and the clearing system to ensure that trading losses do not trigger defaults that may lead to a contagion event in the markets.

3. Special Calls to ICE

In order to obtain analogous trader information from ECMs, the Commission must issue special calls. To date, the Commission has issued three special calls to ICE for information related to ICE's cleared natural gas swap contracts that are cash-settled based on the settlement price of the NYMEX physical delivery natural gas contract. The special calls were issued primarily to assist the Commission in its surveillance of the NYMEX natural gas contract. They were not issued as part of an investigation of any particular market participant or trading activity on either ICE or NYMEX, nor were they issued to conduct regular market surveillance of ICE.

A special call issued on September 28, 2006 requested daily clearing member position data for ICE's natural gas swap contracts, broken out between house and aggregate customer positions, which is similar to information that the Commission receives from NYMEX. The Commission has been receiving responsive data from ICE since October 10, 2006. With this data, market surveillance staff can see all cleared positions at the clearing member level, but it is not possible to determine individual customer positions.

To obtain daily individual trader positions, the Commission issued a further special call on December 1, 2006 and has been receiving responsive data since February 15, 2007. While the data received is similar to large trader reporting for DCMs, the methodology for reporting is very different. As noted above, large trader reporting for products traded on DCMs is done by the carrying firms, generally FCMs for U.S. traders, and foreign brokers for non-U.S. traders. Since the reporting firms have exact data regarding customer positions, this reporting is fairly straight-forward and highly accurate. ICE, however, is a non-intermediated market and therefore does not receive position reporting from firms. Therefore, in order to comply with the special call, ICE developed an algorithm to infer open positions from the sum of all trading by each individual trader. While this approach is innovative and has provided valuable information, it is not as accurate as traditional large trader reporting. ICE is providing information responsive to these first two special calls in the standard electronic format used for Commission large trader reporting, which allows staff quickly to integrate this data into its computer surveillance systems and to examine traders' consolidated positions on NYMEX and ICE.[15]

The most recent special call to ICE was issued on September 5, 2007 and requires ICE to provide all cleared transaction data for its Henry Hub swap contracts and identify counterparties for the final two trading sessions prior to the expiration of prompt month Henry Hub natural gas products. This data is similar to transaction data that the Commission receives from NYMEX for all trading days. When the Commission begins to receive this data, staff will be able to monitor trading activity on ICE during these crucial last two days, in conjunction with its analysis of

[15] The CFTC is receiving all trade data regarding the relevant ICE contracts, while DCMs provide data for only large traders. Overall, the data the CFTC currently receives typically covers roughly 80 to 90 percent of the affected market.

NYMEX trading, to provide more complete coverage to counter possible manipulative schemes that could impact trading on NYMEX.

V. The Commission's ECM Hearing

The Commission's hearing focused on a number of issues, including the tiered regulatory approach of the CFMA and whether this risk-based model is beneficial; the similarities and differences between ECMs and DCMs; the associated regulatory risks of each market category; the types of regulatory or legislative changes that may be appropriate to address identified risks; and the impact that regulatory or legislative changes might have on the U.S. futures industry and the global competitiveness of the U.S. financial industry. The hearing focused largely on energy markets and trading of energy products on ECMs and DCMs.

Many of the witnesses discussed the benefits of competition, innovation, and enhanced market transparency. Generally, the majority view was that some revisions to the ECM provisions may be appropriate, as long as the revisions are prudently targeted and do not adversely affect the ability of established ECMs and start-up ECMs to innovate and potentially to grow into mature markets.

While many witnesses testified that the tiered regulatory structure of the CFMA was successful and should not be eliminated, witnesses also described concerns associated with the current regulatory structure governing ECMs and the regulatory disparity between DCMs and ECMs. These concerns included competitiveness concerns that DCMs operate under more stringent regulatory requirements and responsibilities than ECMs, concerns that energy trading on ECMs contributes to price volatility, and concerns that some market participants and consumers have lost confidence in the integrity of the energy markets.

Addressing price volatility and consumer confidence, Laura Campbell, testifying both on behalf of Memphis Light Gas and Water and the American Public Gas Association (APGA), stated that "APGA's members have lost confidence that the prices for natural gas [in] the futures [and] economically linked over-the-counter markets are accurate reflections of supply and demand" (Campbell at 172). Mark Cooper, representing the Consumer Federation of America, noted that "the lack of regulation of trading . . . has influenced the price of natural gas in a volatile and upward direction" (Cooper at 218). Further, Sean Cota, representing the Petroleum Marketers Association of America, described energy price volatility as a "rollercoaster ride" for consumers and energy traders with the consumer ultimately paying the price (Cota at 239).

Addressing competition and innovation, Dr. James Newsome, President of NYMEX, testified that the current structure has led to innovations and technology advancements that forced NYMEX to change to become more competitive (Newsome at 111). From the market user perspective, Ms. Campbell testified that the ability to view trading at ICE on a daily basis has fundamentally changed the way her company purchases gas and that she would be hesitant to lose the benefits her company has experienced as a result (Campbell at 201). Nevertheless, Ms. Cambpell did suggest that the current law needs to be changed to provide the Commission with the tools "to detect and deter potential manipulative activity before [APGA] members and their customers suffer harm" (Id. at 174).

Peter Krenkel, President of the Natural Gas Exchange (NGX) testified that for NGX "innovation is the key" and that it is critical that regulatory changes not impair the ability to innovate

(Krenkel at 116). Along those same lines, Richard Sandor, Chairman and Chief Executive Officer of the Chicago Climate Exchange, credited the current regulatory structure with providing the ability to operate as an ECM without undue cost and with speed to market for new contracts that helped him form a new exchange (Sandor at 108). In his view, the legal costs of trying to develop innovative products under a highly regulated structure would "limit creativity" (Id. at 115). Similarly, John Damgard, President of the Futures Industry Association, testified that ECMs provide incubation periods for new kinds of trading and new kinds of markets (Damgard at 203). Greg Zerzan of the International Swaps and Derivatives Association recognized this incubation period and the resulting innovation as providing a social benefit that contributes to the United States economy (Zerzan at 242).

There was little support for the option of simply deleting §§ 2(h)(3)-(5) from the Act.[16] The witnesses who addressed this issue generally took the view that increased regulatory oversight might be appropriate for certain contracts traded on ECMs, such as contracts that are "highly linked and functionally equivalent [to] regulated DCM contracts" (Newsome at 87). Even Jeffrey Sprecher, Chairman and Chief Executive Officer of ICE, acknowledged that for certain ICE contracts that are "the economic equivalent of actively-traded futures contracts," a "heightened level of DCM-like regulation … may be appropriate" (Sprecher at 91). However, with respect to other ECM contracts having no nexus to DCM contracts, there was widespread support for retaining §§ 2(h)(3)-(5) in some form.

Dr. Newsome testified that NYMEX does not believe that the case has been made for broadly extending regulation to ECM products that have not triggered "policy interests and concerns" (Newsome at 87). Along those lines, he testified that Congress should move forward with general criteria that capture the natural gas market as it currently exists and if other markets develop similarly, the CFTC should have the flexibility then to capture those markets as well (Newsome at 120). Mr. Krenkel agreed and supported the idea of flexible regulations able to accommodate different types of trade execution facilities given that from NGX's perspective "the ECM regulatory framework has been successful" (Krenkel at 104). By way of example, Mr. Sprecher testified that while ICE's one natural gas "look-alike" contract has gotten much attention, ICE trades 1,000 products on its platform, including lightly traded "exotic derivatives" and "niche products" that would not benefit from regulation as a DCM (Sprecher at 114).

Witnesses supportive of the tiered regulatory approach of the CFMA recognized that the evolution of trading on ECMs deserves a close review by the Commission, particularly in markets where greater market transparency is necessary. Skip Horvath, President of the Natural Gas Supply Association, testified representing producers and marketers of natural gas. He attributed price volatility to the fact that supplies are "artificially constrained" due to gas-prone lands that are off limits, not to problems with the current regulatory system (Horvath at 169). He noted, however, that the current system can be improved, but should be done so prudently (Id. at 170). Mr. Damgard testified that when trading occurs on multiple trading facilities, such as energy products on NYMEX and ICE, it is important that CFTC market surveillance has ready

[16] Only Craig Donahue, representing the CME Group, suggested that "the elimination of the [§ 2(h)(3)] exemption for unregulated commercial markets must be seriously considered (Donahue at 95-6). He argued that the case had not been made that eliminating the ECM category would impair innovation since "innovation can certainly occur in the context of a DTEF or . . . a DCM" (Id. at 112).

access to all relevant large trader information (Damgard at 181). Similarly, John Gaine, President of the Managed Funds Association (MFA), testified that MFA supports the CFTC and others "obtain[ing] access to all relevant surveillance data" (Gaine at 233).

While witnesses advocated some targeted changes, there did not appear to be a widespread call for further regulating the voice-broker or bilateral OTC markets due to the lack of price discovery occurring on these markets and the ability of the Commission to receive certain cleared pricing data and other information regarding these transactions from market participants on a case-by-case basis.

VI. Findings and Recommendations

A. Commission Findings

Based upon the ECM hearing, staff interviews of industry participants, and its general experience administering the CEA, the Commission believes that the CFMA's tiered approach to the regulation of OTC and exchange markets has operated well. The scaling of regulation based upon the financial accreditation and sophistication of transaction parties, the type of commodity underlying the transaction, and the method by which the transaction is undertaken has alleviated much of the legal uncertainty that surrounded derivatives trading before the CFMA. This structure sensibly ensures an appropriate degree of oversight for markets that serve a public interest due to their risk management and price discovery capabilities. It is also important to note that other jurisdictions around the world are adopting a similar tiered regulatory approach to compete with our markets as evidenced by the European Union's implementation of the Markets in Financial Instruments Directive (MiFID).[17]

Of the classes of markets created by the CFMA, the ECM category has proven to be particularly popular for new start-up markets, with the Commission issuing 20 acknowledgement letters to new ECMs since 2000. As was pointed out at the ECM hearing, new markets face regulatory hurdles to achieve and maintain DCM status, notwithstanding the CFMA's establishment of a flexible, principles-based regulatory scheme for DCMs. By comparison, ECMs are largely unregulated with only residual authorities reserved for the Commission. For example, although ECMs are required to retain basic records, to submit limited transaction data to the Commission for higher-volume contracts and to forward participant complaints to the Commission, they have no self-regulatory obligations with respect to trading on their facilities. Similarly, while ECM transactions are subject to the CEA's anti-manipulation and anti-fraud provisions[18], ECMs and ECM participants are not subject to the same type of ongoing Commission oversight measures that the Commission uses to deter and detect manipulation and fraud on DCMs.

The lower level of regulation for ECMs has made that category an ideal platform for markets seeking a low-cost, effective "on-ramp" to launch new ideas for contract design and trading methodologies. As a result, ECMs can serve as incubators for new concepts to see if they take hold in the marketplace. ECMs also can provide competition for DCMs, spurring established DCMs to respond to ECM initiatives with innovations of their own, whether it be developing new products or accelerating their pace of automation.

The Commission believes that the CEA's current level of regulation is appropriate for ECM contracts relying on the § 2(h)(3) exemption when trading volume remains low and their prices are not significantly relied upon by other markets. However, the Commission also believes that

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[17] On October 2, 2007, the CFTC's Global Markets Advisory Committee heard testimony from EU officials regarding the implementation of MiFID and the tiered regulatory categories that are being adopted as part of that effort.

[18] The Commission continues to support amending CEA Section 4b, 7 U.S.C. § 6b, to clarify the Commission's authority to bring fraud actions involving principal-to-principal transactions that occur on ECMs. In the last Congress, such an amendment was included in reauthorization legislation reported by the Senate Committee on Agriculture, Nutrition and Forestry, and in reauthorization legislation passed by the House of Representatives.

when such an ECM contract matures and begins to serve a significant price discovery function for cash or futures market transactions in commodities in interstate commerce, the contract warrants some increased regulatory oversight in order to effectuate the CEA's mandate that the Commission "deter and prevent price manipulation or any other disruptions to market integrity." 7 U.S.C. § 5. Without some increased oversight of trading in relevant mature ECM contracts, the Commission cannot adequately police the trading of DCM contracts to detect and deter price manipulation and other trading abuses.

Beyond addressing these supervisory risks, the current regulatory disparities between ECMs and DCMs also create competitive concerns that may unfairly advantage ECMs due to the restrictions and responsibilities placed on DCMs that do not also apply to ECMs. These competitive concerns arise in the cost to a DCM of complying with its self-regulatory obligations, and more acutely, in the ability of ECMs to allow traders to trade without limit, while DCMs must impose position limits or accountability levels on their traders. Given the Commission's duty to uphold "fair competition"[19] among markets, this is an important consideration in the debate.

The Commission believes that there is a strong public interest in ensuring the integrity of the market for any futures contract that performs a significant price discovery function. Prices that are established by transactions in a contract that serves as a significant price discovery vehicle can affect the prices of commercial transactions and ultimately retail prices for the commodity underlying the contract. It was, of course, the interests of those who use futures markets for price discovery purposes that led Congress to establish a regulatory regime to protect the public interest in the commerce affected by these markets.[20] While the Commission currently has the authority to bring manipulation cases involving ECM transactions, that authority necessarily can only be used after the fact. The Commission has few regulatory tools available to prevent such market abuses from occurring in ECM contracts and to detect them when they occur.

The Commission notes that ECM participation is limited to eligible commercial entities – a fairly sophisticated group of market participants trading on their own behalf. Notwithstanding this limitation, the Commission believes that any significant price discovery function performed by an ECM contract requires a heightened level of oversight. Limiting ECM participation to sophisticated traders does not eliminate the possibility that the exempt commodity contracts traded on an ECM can be manipulated.[21] Further, even if ECM participants do not require the

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[19] 7 U.S.C. § 5.

[20] The *Congressional Record* is replete with discussion of the commercial importance of commodity futures trading. The record recognizes that commercial interests must be able to look to properly functioning commodity markets for market information and products that facilitate the making of marketing, financing and distribution decisions. S. Rep. No. 93-1131, at 12 (1974). The *Congressional Record* also indicates that an initial purpose behind regulating commodity futures trading was to secure fair and orderly markets for producers, and later other commercial participants, who use the markets for price basing and hedging. Hearings on S. 2485, S. 2578, S. 2837 and H.R. 1311 before the Senate Committee on Agriculture and Forestry, 93rd Cong., 2d Sess. at 234; *see also* 80 Cong. Rec. 10739 (April 11, 1974).

[21] Congress recognized this as well when it imposed an anti-manipulation prohibition on ECM transactions. By contrast, under section 2(d)(2) of the Act, Congress did not impose an anti-manipulation prohibition on trading facilities that limit trading to eligible contract participants trading excluded commodities such as financials.

type of customer safeguards typically associated with DCM trading, it does not obviate the public interest in protecting the significant price discovery function performed by an ECM contract. Accordingly, the Commission believes that ECM contracts that become significant sources of price discovery should be subject to a higher level of regulation than is now the case under §§ 2(h)(3)-(5) and the Commission's Regulations thereunder.

It is also important to note that the CFTC hearing, staff interviews, and staff experience in surveillance of these markets do not suggest that the OTC bilateral or voice broker energy markets exhibit significant price discovery attributes. Thus, their direct impact on other parties and markets is limited. In addition, the non-standardized form and significant size and dispersion of these markets would make it extremely costly and difficult to extrapolate beneficial market surveillance information on a routine basis.

B. Commission's Legislative Recommendations

In light of its findings, the Commission recommends the following legislative changes[22] in order to detect and prevent manipulation and to ensure the market integrity of ECM contracts that perform a significant price discovery function for commodities in interstate commerce.[23]

In formulating these recommendations, the Commission has attempted to balance the public interest in allowing ECMs the opportunity to innovate and grow with the public interest in sufficient oversight over the trading on ECMs of contracts that serve a significant price discovery function for commodities in interstate commerce. The Commission's recommendations represent a careful, measured approach to detect and prevent price manipulation and disruptions to market integrity, to ensure fair competition among markets, and to continue to promote the significant innovation brought about by ECMs since the CFMA was enacted.

The Commission's recommendations are contract specific and do not necessarily affect the entirety of an ECM's platform since ECMs host a broad range of products and contracts that may not serve a significant price discovery function. Furthermore, these recommendations apply to all exempt commodities – not just energy – given the concern that any of these exempt products may be susceptible to manipulation once they begin to serve a significant price discovery role.

Once a determination is made that certain ECM contracts serve a significant price discovery function, the new regulatory status of those ECM contracts should be principles-based and should be within the Commission's exclusive jurisdiction. Moreover, by virtue of being within this new regulatory status, the contract will benefit from the Commission's regulatory passport

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[22] The Commission also recommends that Congress should provide the Commission with adequate rulemaking authority in connection with each of the CEA amendments recommended herein so it has the ability to properly implement the provisions.

[23] For the purposes of this report, the Commission has set forth its suggested statutory revisions in broad terms, rather than proposing specific amendatory language. The Commission stresses its willingness to assist Congress and Congressional staff in drafting any CEA revisions implementing these recommendations or regarding any other matter.

regarding trading the contract by market participants located in other jurisdictions around the world.

Authorities Requested

With this in mind, the Commission recommends amendments to the CEA that grant certain authorities to the Commission over ECM contracts that serve a significant price discovery function and certain self-regulatory responsibilities to ECMs over those contracts:

1. Large Trader Position Reporting – An ECM contract that is determined to serve a significant price discovery function should be subject to large trader position reporting requirements comparable to those that currently apply to all DCM contracts. A large trader reporting system would enable the Commission's market surveillance staff to monitor positions on a daily basis to detect and deter possible manipulative schemes. The statutory basis for the Commission regulations that establish a large trader reporting system, Section 4i of the CEA, 7 U.S.C. § 6i, should be amended to apply to an ECM contract that serves a significant price discovery function. That authority over certain ECM contracts would enable the Commission to require position reporting by individual traders and clearing members and to issue special calls to these traders and firms, as needed, for related position data as the Commission currently does for DCM contracts.

2. Position Limits and/or Accountability Level Regime – An ECM should be required to adopt position limits or accountability levels, as appropriate, for a listed contract that serves a significant price discovery function. For cash-settled ECM contracts, such levels ideally would reflect trading activity in the underlying market at the time when the cash settlement price is determined. For any cash-settled ECM contract that is based on a DCM contract's final settlement price, the ECM should establish an agreement with the DCM for obtaining trading volume data during the DCM's final settlement period. For physically-delivered contracts, such levels must reflect deliverable supply. To ensure the Commission's ability to monitor compliance with this obligation, the ECM would be required to provide to the Commission any rules relating to contract terms/conditions and establishing position limits or accountability levels, notify the Commission of any amendments to these rules, and provide any information requested by the Commission when it evaluates the ECM's requirements and procedures.

3. Self Regulatory Oversight – An ECM should be required to monitor trading of a listed contract that serves a significant price discovery function to detect and prevent manipulation, price distortion, and disruptions of the delivery or cash-settlement process. As part of this monitoring, an ECM should collect market data and trading information and provide such information, upon request, to the Commission.

4. Emergency Authority – The CEA should be amended to require an ECM to adopt rules to provide for the exercise of emergency authority to alter or supplement contract rules, liquidate open positions, and to suspend or curtail trading in any listed contract that serves a significant price discovery function. The Commission should be granted similar emergency authority relative to these price discovery contracts (authority the Commission has relative to

DCMs). These authorities for an ECM and the Commission would be essential tools to prevent manipulation and disruptions of the delivery or cash-settlement process.

It is the Commission's belief that, for ECM contracts that serve a significant price discovery function, these additional authorities and responsibilities are measured and appropriate and will ensure fairness by conferring responsibilities on ECMs consistent with those applicable to DCMs in Core Principles 3, 4, 5, and 12. *See* 7 U.S.C. §§ 7(d)(3), (4), (5), and (12).

In light of the legislative changes proposed, the Commission must also revisit its rulemaking that requires the reporting of a product's volume and prices if it serves a significant price discovery function so that the rulemaking can reflect the legislative changes recommended herein.

Significant Price Discovery Standard

A determination of whether an ECM contract serves as a significant source of price discovery should: (1) include measures that are quantifiable and verifiable to ensure decision making is simplified and transparent; (2) seek to minimize the costs of administration imposed on the Commission and the costs of compliance imposed upon the ECMs; and (3) recognize that start-up ECMs and new contracts will generally not have sufficient liquidity to serve as a significant source of price discovery.

Consistent with these general principles, the Commission believes Congress should instruct the Commission to use the following factors in determining whether a contract serves a significant price discovery function:

> **Material Liquidity:** The volume of trading of the relevant contract must be high enough to be able to impact other regulated contracts or to become an independent price reference or benchmark that is regularly utilized by the public. In this context, consideration should be given to the size of the relative market of the underlying commodity and the susceptibility of these markets to manipulation; and
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> **Linkage/Material Price Referencing:** The linkage of ECM pricing to the settlement terms of a regulated contract on a DCM is an indication of significant price discovery since this allows for easier substitution of products between the linked markets. Material price referencing of ECM contracts also can indicate that significant price discovery is occurring when prices of ECM contracts are referenced in setting the price in other transactions in commodities in interstate commerce on a frequent and recurring basis.[24]

C. Other Recommendations

In addition to the legislative amendments recommended above, the Commission intends to undertake two initiatives to promote greater understanding of trading in energy futures products.

[24] Although not a factor directly relating to price discovery, clearing of products may indicate that a product is more standardized and mature, and more likely to be linked or serve as a material price reference for transactions in commodities in interstate commerce.

The Commission plans to establish an Energy Markets Advisory Committee to conduct public meetings on issues affecting energy producers, distributors, market users and consumers, as well as others interested in or affected by energy futures markets. The Commission believes that an Energy Markets Advisory Committee will facilitate regular communications between the Commission and the diverse energy-related interests affected by these markets.

The Commission proposes to work closely with the Federal Energy Regulatory Commission (FERC) to educate and develop best practices for utilities and others who use NYMEX settlement prices as benchmarks in pricing their energy products. These efforts would focus on ensuring that these organizations fully understand the mechanics of the settlement processes at NYMEX and on working with these organizations and NYMEX to develop different benchmarking approaches if appropriate. The CFTC and FERC should also help educate these end users of energy on how to utilize the futures and other derivatives markets in managing price risk and volatility.